

TRANSCRIPT OF RECORD.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1922.

No. 724.

**ATLANTIC COAST LINE RAILROAD COMPANY,
APPELLANT,**

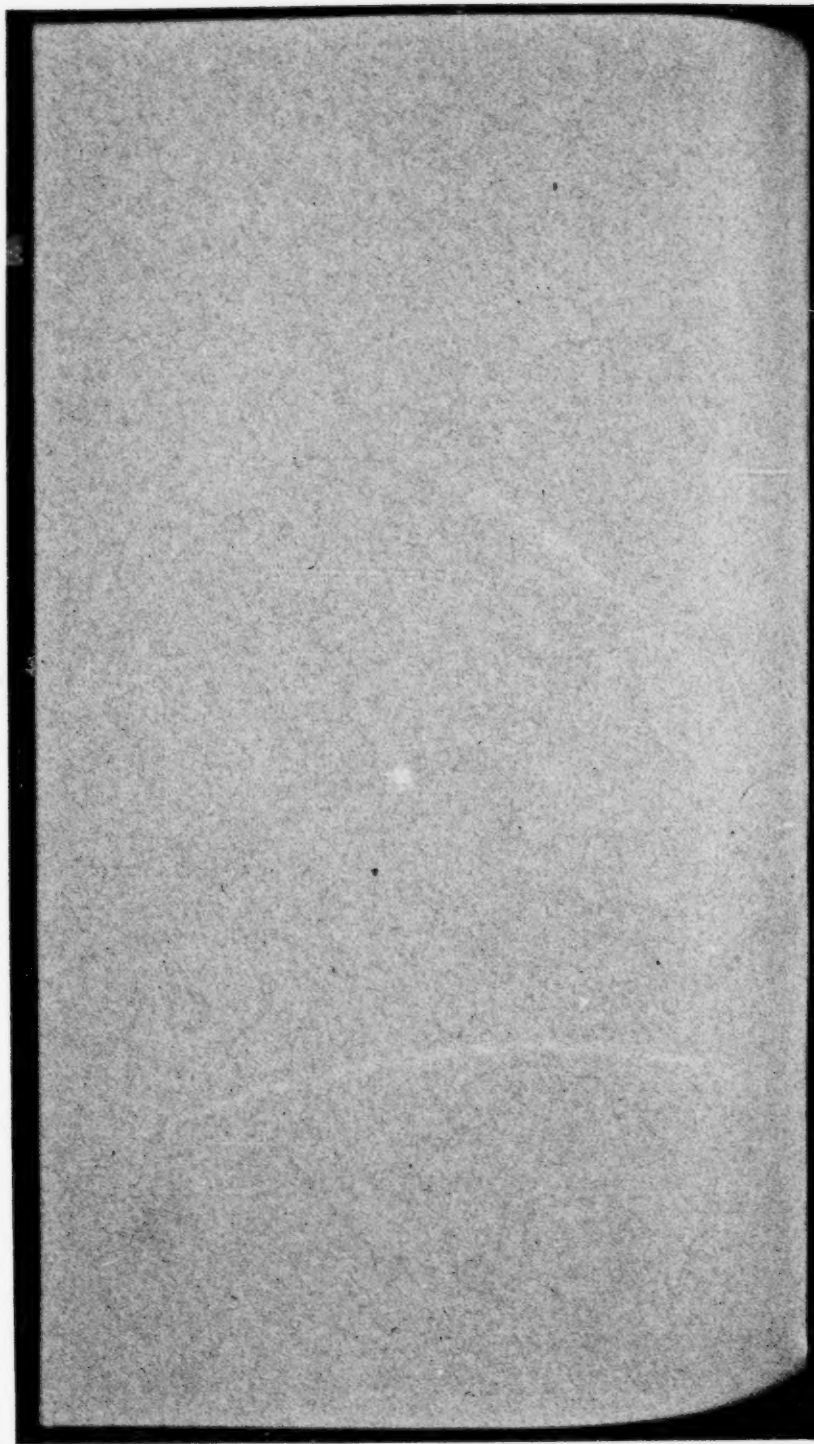
vs.

**A. D. WATTS, COMMISSIONER OF REVENUE OF THE
STATE OF NORTH CAROLINA, ET AL.**

**APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR
THE EASTERN DISTRICT OF NORTH CAROLINA.**

FILED DECEMBER 9, 1922.

(29,274)



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TRANSCRIPT OF RECORD.

In the District Court of the United States for the Eastern District of North Carolina.

At a District Court of the United States for the Eastern District of North Carolina begun and held at the court-house, in the city of Raleigh, on the fourth Monday after the fourth Monday in October, being the 20th day of November, in the year of our Lord one thousand nine hundred and twenty-two.

Present: The Honorable Henry G. Connor, Judge of the District Court for the Eastern District of North Carolina.

Among others were the following proceedings, to-wit:

In Equity.

ATLANTIC COAST LINE RAILROAD COMPANY

vs.

A. D. WATTS, Individually and as Commissioner of Revenue of North Carolina, et al.

Bill of Complaint.

Filed Mar. 31, 1922.

In the United States District Court for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Individually and as Commissioner of Revenue of North Carolina; Benjamin R. Lacy, State Treasurer of North Carolina; Baxter Durham, State Auditor of North Carolina; James S. Manning, Attorney General of North Carolina, and Frank Nash, Assistant Attorney General of North Carolina, Defendants.

To the Honorable H. G. Connor, Judge of the District Court of the United States for the Eastern District of North Carolina:

The Atlantic Coast Line Railroad Company, a corporation duly organized, created and existing under and by virtue of the laws of the State of Virginia, and a citizen and resident of said State, brings this its Bill of Complaint against A. D. Watts, Individually and as

Commissioner of Revenue of North Carolina, a citizen of the State of North Carolina, whose individual residence is in the County of Iredell in said State, and in the Western District thereof, and

whose official residence as Commissioner of Revenue of North Carolina is at the City of Raleigh in said State, and in the

Eastern District thereof; Benjamin R. Lacy, Treasurer of the State of North Carolina, and a citizen and resident of the County of Wake, in the Eastern District of said State, Baxter Durham, Auditor of the State of North Carolina, and a citizen and resident of the County of Wake, in the Eastern District of said State; James S. Manning, Attorney General of the State of North Carolina, and a citizen and resident of the County of Wake, in the Eastern District of said State, and Frank Nash, Assistant Attorney General of the State of North Carolina, a citizen of the State of North Carolina, whose individual residence is in the Town of Hillsboro in said State, and in the Western District thereof, and whose official residence as Assistant Attorney General of North Carolina is at the City of Raleigh in said State and in the Eastern District thereof.

And thereupon complainant complains and prays:

1. That the complainant was at all times hereinafter mentioned and is now, a corporation duly created, organized and existing under and by virtue of the laws of the State of Virginia, and is a citizen of said State, and is not a citizen of the State of North Carolina, and that it did at all times hereinafter mentioned, and does now, operate, lease and control lines of railroad and other property in and through the States of Virginia, North Carolina, South Carolina, Georgia, Florida and Alabama, and is now and was at all such times operating said lines of railroad in interstate commerce. The total mileage of road so operated, owned, leased and controlled by the complainant as of May 1, 1921, in the State of North Carolina, and elsewhere, was 4,889.76 miles, and the total miles of road, operated, owned, leased or controlled by complainant as of said date was distributed between mileage in the State of North Carolina and outside of the State of North Carolina (by separate lines, divisions and branches), as is shown in the following statement:

4	Virginia	147.29
	North Carolina	1,043.79
	South Carolina	929.41
	Georgia	725.95
	Florida	1,791.62
	Alabama	251.70
	Total	4,889.76

The ratio of proportion which the length of the lines leased, operated or controlled in North Carolina bore to the total length of miles operated, owned, leased or controlled in the State of North Carolina and elsewhere was .21316 per cent.

2. That the defendant A. D. Watts is Commissioner of Revenue of North Carolina, duly appointed by the Governor of North Caro-

lina, and under and by virtue of Chapter 40 of the Public Laws of North Carolina of 1921, and duly qualified under the laws of said State and is a citizen of the State of North Carolina, whose individual residence is in the County of Iredell in said State, and in the Western District thereof, and whose official residence as Commissioner of Revenue of North Carolina is at the City of Raleigh, in said State, and in the Eastern District thereof; that the defendant Benjamin R. Lacy is the State Treasurer of the State of North Carolina, duly elected and qualified under the laws of the said State and is a citizen and resident of the County of Wake in the Eastern District of said State; that the defendant Baxter Durham is the State Auditor of the State of North Carolina and is a citizen and resident of the County of Wake, in the Eastern District of said State; that the defendant James S. Manning is Attorney General of the State of North Carolina and a citizen and resident of the County of Wake, in the Eastern District of said State; that the defendant Frank Nash is Assistant Attorney General of the State of North Carolina, and is a citizen of the State of North Carolina, whose individual residence is in the Town of Hillsboro, in the said State, and in the Western District thereof, and whose official residence as Assistant Attorney General of the State of North Carolina is in the City of Raleigh in said State, in the Eastern District thereof.

3. That this is a suit in equity and arises under the laws and Constitution of the United States, as will hereinafter particularly appear, and the amount in controversy in this case, exclusive of interest and cost, as will be more specifically shown, exceeds the sum and value of three thousand dollars (\$3,000.00). Among other things this suit is brought to redress and prevent the deprivation under color of the several statutes of North Carolina of certain rights and immunities secured to the complainant by the Constitution of the United States—that is, the right to have and enjoy its property without being deprived thereof without due process of law, and without being denied the equal protection of the law, and this suit involves the further question as to whether certain taxes sought to be made and imposed upon complainant under color of the several statutes of the State of North Carolina interfere with, burden, obstruct and regulate commerce with the foreign nations and among the several states and taxes the property of this complainant outside of the State of North Carolina in contravention of the Constitution of the United States and the Fourteenth Amendment and commerce clause thereof,

4. The complainant shows that the provisions of the Constitution of North Carolina, Article 5, Section 3, authorizing the levy of an income tax on itself and other railroad corporations are as follows:

"Taxation shall be by uniform rule and ad valorem

Exemptions.—Laws shall be passed taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint stock companies, or otherwise; and, also, all real and personal property, according to

its true value in money: Provided, notes, mortgages, and all other evidence of indebtedness given in good faith for the purchase price of a home, when said purchase-price does not exceed three thousand dollars, and said notes, mortgages, and other evidence of indebtedness shall be made to run for not less than five nor more than twenty years, shall be exempt from taxation of every kind: Provided, that the interest carried by such notes and mortgages shall not exceed five and one-half per cent. The general assembly may also tax trades, professions, franchises, and income: Provided, the rate of tax on incomes shall not in any case exceed six per cent (6%) and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes, to wit: for a married man with a wife living with him, or to a widow or widower having minor child or children, natural or adopted, not less than \$2,000; to all other persons not less than \$1,000, and there may be allowed other deductions (not including living expenses) so that only net incomes are taxed."

5. The complainant shows that the Legislature of North Carolina, at its regular session in 1921, purporting to act under the authority of the provision of the Constitution above quoted, enacted a law providing for the levying, collecting and paying of an income tax on individuals and corporations, the said law forming a part of the Revenue Act of 1921, being Chapter 34 of the Public Laws of North Carolina of 1921. It is provided by Section 100 of said Revenue Act that the income tax schedule should be known and cited as the Income Tax Act of 1921, and said Act will be so referred to in this bill of complaint.

6. Section 101 of the Income Tax Act of 1921, as amended by the General Assembly of North Carolina, special session of 1921, is as follows:

"Sec. 101. Purpose.—The general purpose of this act is to impose a tax, for the use of the State Government, upon the net income for the calendar year 1921, in excess of exemptions herein set out, collectible in the year 1922, and annually thereafter:

(a) Of every citizen of the State;

(b) Of every domestic corporation;

7 (c) Of every foreign corporation and of every non-resident individual having a business agency in this State, in proportion to the net income of such business or agency.

Except as otherwise provided in this act the purpose is to conform to the definition of income in the revenue laws of the United States Government and regulations made under its authority, in so far as they apply.

The tax imposed upon the net income of corporations in this schedule is in addition to the tax imposed under Schedule C of this act."

7. Section 201 of the Income Tax Act of 1921, as amended by the General Assembly of North Carolina, Special Session of 1921, is as follows:

"Sec. 201. Corporations. Every corporation organized under the laws of this State shall pay annually an income tax equivalent to three per cent of the entire net income of such corporations as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules:

"In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale, or rental of real estate, or from the manufacture, sale or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of encumbrances thereon.

"In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State."

8. Section 202 of the Income Tax Act of 1921 is as follows:

"Sec. 202. Railroads and Public Service Corporations.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporation as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross 'operating revenues' within this State, including in their gross 'operating revenues' within this State the equal mileage proportion within this State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of 'operating expenses,' or 'operating ratio,' for their whole business as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted 'uncollectible revenue,' and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act."

9. The foregoing section relating to the basis of ascertaining the net income of railroads was supplemented by Chapter 35 of the Public Laws of 1921, as follows:

9 "Section 1. That in determining the taxable income of a corporation engaged in the business of operating a railroad under section two hundred and two of the act to raise revenue, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire."

10. Section 203 of the Income Tax Act of 1921, as amended by Chapter 35, Public Laws of 1921, is as follows:

"Sec. 203. Such tax shall first be levied, collected, and paid in the year 1922, and with respect to the net income received during the calendar year 1921 and annually thereafter."

11. Section 3 of Chapter 34, Public Laws of 1921, provides:

"No tax on any property in the State shall be levied for any of the uses of the State Government. The taxes hereinafter levied in this act are for the expenses of the State Government, the appropriations to its educational, charitable, and penal institutions, pensions for Confederate soldiers and widows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer."

12. Complainant shows that the said Income Tax Act of 1921 is unconstitutional and void in its application to complainant and other railroads for the following reasons:

(a) For that it is not a tax on income as authorized in Article 5, Section 3, of the Constitution of North Carolina, but is in truth and in fact a tax upon operating revenue derived by railroad companies from interstate and intrastate commerce, and for the reason that from the operating revenue arrived at under the said law there are not allowed many of the deductions required by the Standard Classification of Accounts of the Interstate Commerce Commission which Standard Classification of Accounts was promulgated by the said Interstate Commerce Commission under the provisions of the Interstate Commerce Act passed by Congress, and which are so regulated as to ascertain what is the net income of railroads engaged in interstate commerce. Complainant says that among other items which are directed to be deducted by railroads in interstate commerce from operating income, in order to arrive at net income, are the following:

Joint facility rents,
Rent from leased roads,
Miscellaneous rents,
Miscellaneous tax accruals,
Separately operated properties—loss,
Interest on funded debt,
Interest on unfunded debt,
Amortization of discount on funded debt,
Maintenance of investment organization,
Income transferred to other companies,
Miscellaneous income charges.

and avers that in order to ascertain the net income of railroad companies engaged in business in interstate commerce, as complainant is, according to said Standard Classification of Accounts of the Interstate Commerce Commission, promulgated as aforesaid, it is necessary to deduct the above items.

(b) The method of arriving at net income does not result in the ascertainment of net income as the same is defined and arrived at under the Standard Classification of Accounts of the Interstate Commerce Commission, in that the Standard Classification of Accounts directs that there shall be deducted from the net operating income not only the deductions provided for in said law of North Carolina, but in addition thereto the following:

Joint facility rents,
Rent from leased roads,
Miscellaneous rents,
Miscellaneous tax accruals,
Separately operated properties—loss,
Interest on unfunded debt,
Interest on funded debt,
Amortization of discount on funded debt,
Maintenance of investment organization,
Income transferred to other companies,
Miscellaneous income charges.

The result is that the machinery provided for by the said statute for the ascertainment of net income does not in truth and in fact produce net income, which under Section 101 is declared to be the purpose of the said act to tax. Furthermore, the method outlined in said law for arriving at net income produces a figure which is not the true net income, but which contains in part gross income, and insofar as it does include gross income, which gross income is derived from interstate commerce, said tax is a direct burden upon interstate commerce and is void under the Commerce Clause of the Constitution of the United States.

(c) Complainant further says that the statute is unconstitutional and void for that by Section 306 it permits corporations other than the corporations named in Section 202 to deduct:

(1) All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

(a) As to individuals, wages of employees for services actually rendered in producing such income.

(b) As to partnerships, wages of employees and a reasonable allowance for co-partners or members of a firm for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the co-partner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

(2) Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade or property to which the taxpayer has not taken or is not taking title or in which he has no equity.

(3) All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

(4) Taxes for the income year, except taxes on income and war profits and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

(5) Dividends from stock in any corporation, the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act; Provided, that when only part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted.

(6) Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

(7) Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

(8) A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the cases of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that, in computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits, the cost of development, not otherwise deducted), and in the case of property acquired prior to January 1st, 1921, the fair market value of the property (or the taxpayer's

interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases the deductions allowed may be equitably apportioned between the lessor and lessee.

(9) In the case of taxpayers who keep regular books of account, upon an accrual basis, and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall at any time deem the reserve excessive in amount, it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

(10) Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision.

(11) Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such net income. The deduction authorized in this subsection shall in no case extend to any part of income of resident individuals from personal services, or mortgages, stocks, bonds, securities and deposits.

14 (12) In the case of a non-resident individual, the deductions allowed in this section shall be allowed only if, and to the extent, that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission.

13. The said Income Tax Act of 1921, in violation of the Constitution of North Carolina and the Constitution of the United States, creates a discrimination against the complainant and other railroad companies of similar character in favor of other corporations and individuals in that said act in order to ascertain the taxable income allows other corporations and individuals certain deductions, set out in paragraph 12, many of which said deductions are not allowed to complainant and other railroad corporations of similar character, and all of which are deductions which must be made in order properly to determine net income.

14. Complainant shows that under the provisions of the Income Tax Act of 1921, and particularly Section 202, Section 300, and Section 306, all corporations, except railroads and public service cor-

porations, which are required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, are required to pay a tax on their net income, which is defined by Section 300 as "the gross income of a taxpayer, less the deductions allowed by this act," whereas complainant and other railroads and public service corporations, which are required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, are not allowed the deductions set forth in the said Act, except "uncollectible revenue," and taxes paid in the State for the income year, other than income taxes, war profits and excess profits taxes, and certain deductions for car hire, and complainant shows that it, and other railroad companies and public service corporations of similar character referred to in Section 202 of the Income Tax Act of 1921 are denied large deduc-

15 tions which are granted other railroads, corporations and individuals, and particularly the deduction of interest paid during the income year, which results in discrimination against the complainant in violation of the Constitution of North Carolina, and "denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment to the Constitution of the United States."

15. Complainant shows that the said Income Tax of 1921 does not operate equally and uniformly upon all taxpayers in similar circumstances, and that the complainant and other railroads and public service corporations, which are required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, have been arbitrarily selected and taxed upon a more burdensome basis and one that is different from that applied to corporations in general, and to other corporations engaged in business similar to that of complainant in violation of the Constitution of North Carolina, and "denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment to the Constitution of the United States."

16. Complainant shows that the income tax levied by the said Income Tax Act of 1921 is not levied by a uniform rule as required by the Constitution of North Carolina, Article 5, Section 3, and the lack of uniformity works greatly to the detriment of complainant, in violation of said Article 5, Section 3, of the Constitution of North Carolina, and "denies the complainant the equal protection of the law and deprives it of its property without due process of law in contravention of the Fourteenth Amendment to the Constitution of the United States."

17. Complainant shows that the classification of taxpayers for the purpose of fixing the income on which the tax shall be paid as made by the said Income Tax Act of 1921 is not based upon any reasonable ground, but is a mere arbitrary selection, so far as the cor-

16 porations set forth in Section 202 are concerned, and was made for the purpose and has the result of imposing upon

such corporations, including complainant, an unjust burden of taxation, in violation of the Constitution of North Carolina and denies the complainant the equal protection of the law and deprives it of its property without due process of law, in contravention of the Fourteenth Amendment to the Constitution of the United States."

18. Complainant shows that the method of fixing its taxable income as provided by Section 202 of the said Income Tax Act of 1921 violates the Constitution of North Carolina, and the Constitution of the United States, because it does not apply to railroads and public service corporations which derive their income from sources other than the operation of their property, which results in a lack of uniformity in the application of the income tax and in discrimination against complainant, and therein "denies the complainant the equal protection of the law and deprives it of its property without due process of law, in contravention of the Fourteenth Amendment to the Constitution of the United States."

19. Complainant shows that the tax imposed upon complainant by Section 202 of the Income Tax Act of 1921 is unconstitutional and void because the authority of the Legislature of North Carolina to tax incomes is derived from Section 3, Article 5, of the Constitution of North Carolina, and said section provides that only net incomes may be taxed, and in attempting to tax the "operating revenues" of complainant, the said Act violates the Constitution of North Carolina, and "denies complainant the equal protection of the law and deprives it of its property without due process of law, in contravention of the Fourteenth Amendment to the Constitution of the United States."

20. Complainant further shows that the statute is violative of Article 5, Section 3, of the Constitution of North Carolina, for that it does not levy upon railroads and other public service corporations named in said Section 202, a tax on net income, but levies a tax upon operating revenue derived from interstate and intrastate commerce, and does not permit the deductions necessary and incidental to the business of complainant, and expended by it from said income in order to determine net income, and is in violation of the interstate commerce clause Section 8, Article 1 of the Constitution of the United States in that it permits a tax as an income tax to be placed on gross income derived from interstate commerce, thereby directly burdening interstate commerce.

21. Complainant shows that the Income Tax Act of 1921 violates the Transportation Act of Congress and the Interstate Commerce Act, in that it seeks to prescribe a method of accounting by this interstate carrier, when said Acts of Congress have delegated the power to prescribe said accounting to the Interstate Commerce Commission, and the said Commission has prescribed and directed that the complainant, and other interstate carriers, keep their accounts in accordance with the methods prescribed by it.

22. Complainant shows that the State of North Carolina, by its tax laws, permits the counties, cities, towns, townships and special taxing districts to levy on the assessed value of complainant's property known as an ad valorem tax, which is based upon the whole property of complainant, tangible and intangible, and to this the tax laws of the State adds a so-called franchise tax of one-tenth of one per cent. on the same assessed value, and by the statutes hereinbefore referred to, the Legislature of North Carolina has levied, and unless restrained, the defendants in this action will undertake to collect an additional tax characterized as an income tax of three per cent on complainant's net operating revenue, including revenue derived from interstate commerce, and complainant avers that this system of pyramiding taxes, and the entire scheme of taxation, amounts to a regulation of commerce between the states, because, necessarily, a tax of one-tenth of one per cent upon the tangible and intangible property of this complainant, and a tax of three per cent upon its net operating revenue, including revenue derived from interstate commerce, are taxes upon interstate commerce, the property, tangible and intangible, having already been taxed at its full value, and complainant shows that this scheme of taxation levies a tax and burden upon the interstate commerce of complainant, and violates the commerce clause of the Constitution of the United States. Section 8, Article 1.

23. Complainant further shows that the statutes imposing an income tax upon complainant are unconstitutional and void in that they are violative of the scheme of taxation created and made mandatory by the Constitution of North Carolina. That instrument provides a dual system of taxation, one set of taxes being leviable by the State, and the other by the counties and other governmental subdivisions. The complainant, therefore, avers that the scheme of taxation brought about by the tax laws of North Carolina, whereby the State derives its entire revenue from taxes other than a tax on property is unwarranted by the Constitution of North Carolina, which, by its mandate, requires that all property shall bear its just proportion of the burden of taxation, and that laws shall be passed taxing by a uniform rule all moneys, credits, investments in bonds, stocks, joint stock companies, or otherwise, and also all real and personal property according to its true value in money, (Article 5, Section 3), and the complainant shows that the North Carolina Legislature has no power to exempt a large class of property from liability to taxation for state purposes, as is done by Section 3, Chapter 34, Public Laws of 1921, and recoup the loss of revenue thereby occasioned by taxation other than a tax on property. Such method or scheme of taxation is plainly at variance with that intended to be established by the Constitution of North Carolina, and, consequently,

19 Section 202, which attempts to impose a part of this additional burden of taxation upon the complainant, is void, in that it violates the Constitution of North Carolina, and denies the complainant the equal protection of the law and deprives the complainant of its property without due process of law in violation of the Fourteenth

Amendment to the Constitution of the United States, and complainant further shows that the said scheme of taxation is unconstitutional and void, in that the complainant is charged with an undue proportion of the expenses of the State government, and a greater proportion of the burden of taxation than is warranted by the Constitution of North Carolina, in that complainant is required by the tax laws of North Carolina to pay to counties, cities and towns, and special tax districts, large sums as taxes on the assessed value of its property, and in addition thereto, a so-called franchise tax of one-tenth of one per cent on its assessed value of \$51,163,717.00, and the income tax of three per cent on its net operating revenue.

24. Complainant further shows that said tax for the calendar year 1921 is unconstitutional and void because it is retroactive to the extent that it attempts to tax income for the months of January, February, and eight days in the month of March, 1921, the said Act having been ratified March 8th, 1921, and being effective from and after its ratification.

25. Complainant shows that a form for the income tax return for the calendar year ending December 31st, 1921, has been received by complainant, which requires said return to be made in conformity with the provisions of Section 202 of the Income Tax Act of 1921, and complainant is required by law to file said return with the Commissioner of Revenue on or before March 15th, 1922, and said return, as required by said form, will show \$1,389,565.09 as the amount on which complainant will be taxed at the rate of three per cent (3%), and the tax which the complainant will be required to pay to the State of North Carolina on or before March 15th, 1922, is \$41,686.96, whereas the true income of the complainant for the calendar year ending December 31st, 1921, is \$333,205.09, and whereas the said tax if paid upon the true net income, according to the Standard Classification of Accounts of the Interstate Commerce Commission, or according to any other method which would result in net income, is \$9,996.15, and unless the defendants are restrained and enjoined from doing so, they will proceed on or after March 15th, 1922, to assess said tax and collect the same from complainant. It is further shown that under the laws of North Carolina, the said tax will become a lien upon the property of complainant, and will be a cloud upon its title, and the enforcement of said tax by execution would interfere with the conduct of complainant's business as an interstate carrier, and it is further shown that, upon the collection of said tax, the amount thereof will pass into the Treasury of the State of North Carolina, and the complainant is without remedy by which it can obtain refund thereof, all to the irreparable damage of complainant, and for which it has no adequate remedy at law. Plaintiff attaches hereto a copy of the report upon the form which it will be required to make to the said Commissioner of Revenue, as Exhibit A, and a statement showing the correct net income, as Exhibit B.

26. Complainant shows that Section 600 of the said Income Tax Act of 1921 imposes certain penalties upon a taxpayer who fails to pay

any taxes levied by the said act, said penalties, among other things being double the amount of the taxes. Complainant avers that said penalties are excessive, unreasonable, oppressive and inequitable; that it is a denial of the due process of law for the said act to impose said penalties upon the complainant who is proceeding with due diligence to have it judicially determined whether or not said act is valid, the complainant in good faith asserting that said act is not valid. The complainant therefore avers that even though the said act should finally be declared valid the said penalties ought not to be imposed upon the complaint.

21

Prayer.

Wherefore, and for as much as Complainant is remediless in the premises, according to the common law, and remediable only in equity, and that complainant may not be subjected to the many penalties provided by the said laws, and may not suffer irreparable injury and damage, and may not have its property taken from it without due process of law, may not be denied the equal protection of the laws, and may carry on its business untrammelled by the burdens imposed by the laws of North Carolina, may be permitted to pursue and carry on its business without unlawful hinderance and destruction, and that the railroad operated by complainant in the State of North Carolina as aforesaid, and its property may not be subjected to illegal liens, complainant prays for a writ of subpoena to issue against the defendants and each and every one of them named and described as aforesaid to appear and full and true answer make to this bill of complaint, but not under oath, answer under oath being waived, and that said defendants, and each and every one of them, be enjoined by final decree, and meanwhile, by a preliminary injunction, as follows, to wit:

That said A. D. Watts, Commissioner of Revenue of North Carolina, be enjoined and restrained from taking, or causing to be taken, any action toward enforcing the tax or penalties, or any part thereof, which the said Income Tax Act of 1921 imposes upon the complainant or its property within the State of North Carolina.

That Baxter Durham, as Auditor of North Carolina, be enjoined and restrained from charging to complainant for collection, and that Benjamin R. Lacy, as State Treasurer, be enjoined and restrained from collecting from complainant the tax or any part thereof imposed by said act.

That James S. Manning, as Attorney General of North Carolina, and Frank Nash, as Assistant Attorney General of North Carolina, be enjoined and restrained from instituting or authorizing the institution of any suit or proceedings to collect the said tax or penalties.

Complainant further prays that the tax statutes of North Carolina herein alleged to be unlawful be decreed by this court to be unconstitutional and invalid, and that no assessment for taxation be made against the complainant thereunder, and no tax be levied against or collected from the complainant thereunder; and for all

such other, further, general and special relief to which in equity it may be entitled.

This is the first application for an injunction in this cause.

THOMAS W. DAVIS,
Solicitor for Complainant.

GEORGE B. ELLIOTT,
SKINNER & WHEDBEE,
Of Counsel.

STATE OF NORTH CAROLINA,
County of New Hanover:

R. D. Cronly, being duly sworn, deposes and say that complainant, Atlantic Coast Line Railroad Company is a corporation, and that he is one of its officers, to wit, Assistant Secretary; that he has read the foregoing bill of complaint and knows the contents thereof; that the same is true of his own knowledge, except as to those matters therein set forth on information and belief, and as to those matters he believes it to be true.

R. D. CRONLY. [L. S.]

Sworn to and subscribed before me this the 10th day of March, 1922.

[SEAL.]

B. B. REYNOLDS,
Notary Public.

My commission expires January 31st, 1924.

EXHIBIT "A" TO BILL.

State Department of Revenue.

Public-Service Corporation Income Tax Returns.

(Railroads.)

For Calendar Year Ending December 31, 1921.

Name, Atlantic Coast Line Railroad Company.
Business address, Wilmington, N. C.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the Revenue Act of 1921 and the Regulations issued under authority thereof.

President.

Treasurer.

Sworn to and subscribed before me this — day of —, 1922.

(Official capacity.)

*Net operating income (when business is wholly within the State).....	
*Net operating revenue, including equal mileage proportion within this State of the interstate business (when business is in part within and in part without the State).....	\$16,561,435.11
Other income.....	
Total income.....	\$16,561,435.11
*Operating expenses (when business is wholly within the State).....	
*Proportionate average of operating expenses (when business is in part within and in part without the State).....	\$14,596,266.11
*Uncollectible revenue.....	20,518.08
Taxes paid in this State, other than income and war profits and excess profits taxes.....	458,290.43
Total deductions.....	\$15,075,074.62
Operating income, less deductions.....	\$1,486,360.49
Plus or Minus any credit or debit balance received or paid on account of car hire. And when any railroad is partly within and partly without the State then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid.....	96,795.2012
Net taxable income.....	\$1,389,565.29
Tax at 3 per cent.....	\$41,686.96
Main track mileage (system).....	4,894.34
Main track mileage (State).....	1,042.70

24 Railroads and Public-service Corporations; Basis of Ascertaining Net Income.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the "net operating income" of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross "operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their in-estate business and deducting from their gross "operating

*As per standard Classification of Accounts of Interstate Commerce Commission.

revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this State for the income year other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act.

Car Hire Considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

EXHIBIT "B" TO BILL.

EXHIBIT "B."

Atlantic Coast Line Railroad Company.

Office of Comptroller.

Statement of Income Applicable to State of North Carolina for Year Ended December 31st, 1921. According to the Classification of Accounts Prescribed by the Interstate Commerce Commission.

I. Operating Income:

501. Railway Operating Revenues.....	\$16,561,435.11
531. Railway Operating Expenses.....	14,596,266.11
Net Revenues from Railway Operations	\$1,965,169.00
532. Railway Taxes Paid	458,290.46
533. Uncollectible Railway Revenues.....	20,518.08
Railway Operating Income.....	1,486,360.46

II. Non-operating Income:

Equipment Rents (Accts. 503 to 507 and 536 to 540 Net.....	†98,248.14
508. Joint Facility Rent Income.....	78,279.68
509. Income from Lease of Road.....	56.60
510. Miscellaneous Rent Income.....	26,090.32
511. Miscellaneous Nonoperating Physical Property	25,709.11
513. Dividend Income	436.64
514. Income from Funded Securities.....	40,893.47
515. Income from Unfunded Securities and Accounts	31,135.18
519. Miscellaneous Income	197.84
Total Operating Income.....	106,550.44
Gross Income	1,592,910.68

III. Deductions from Gross Income:

541. Joint Facility Rents.....	9,442.30
542. Rent for Leased Roads.....	3,000.00
543. Miscellaneous Rents	2,022.42
546. Interest on Funded Debt.....	1,214,596.34
547. Interest on Unfunded Debt.....	18,919.87
551. Miscellaneous Income Charges.....	11,724.68
Total Deductions from Gross Income	1,259,705.81
Net Income	333,205.08

Wilmington, N. C., March 10th, 1922-o.

26 UNITED STATES OF AMERICA,
Eastern District of North Carolina:

District Court at Raleigh, Fourth Circuit.

The United States of America to A. D. Watts, Comr. of Revenue Raleigh, N. C.; B. R. Lacy, State Treasurer, Raleigh, N. C.; Baxter Durham, State Treasurer, Raleigh N. C.; Jas. S. Manning Attorney General, Raleigh, N. C.; Frank Nash, Asst. Atty. General of State of North Carolina, Greeting:

We command you, and every of you, that you appear before the Judges of our District Court of the United States of America, for the Eastern District of North Carolina, at the office of the Clerk of said Court, in the City of Raleigh, in said District, on the 19th day of April next, to answer the Bill of Complaint of Atlantic Coast Line Railroad Co., citizen and resident of the State of Virginia filed in the Clerk's office of said Court, in said City of Raleigh, there and there to receive and abide by such Judgment and Decree as

†Deficit.

shall then or thereafter be made, upon pain of Judgment being pronounced against you by default.

To the marshal of the eastern district of North Carolina to execute.

Witness, The Hon. William Howard Taft, Chief Justice of the Supreme Court of the United States, at Raleigh, in said District, the 1 day of Mar., 1922, and in the 146 year of the Independence of the United States.

Issued the 31 day of March, 1922.

[Seal of the Court.]

S. A. ASHE,

Clerk U. S. District Court.

The within-named defendants are notified that unless they enter their appearance in the Clerk's office of said District Court at Raleigh and file their answer, or other defense, on or before the 20th day after service hereof, excluding the day of service, the bill filed herein will be taken as confessed and a decree entered accordingly.

S. A. ASHE,

Clerk U. S. District Court.

[Endorsed:] No. 448. Equity. In United States District Court Eastern District of North Carolina at Raleigh. Atlantic Coast Line Railroad Co. against A. D. Watts, Comr. of Revenue et al. Equity Subpoena. Returnable the 19 day in April, 1922. Duplicate original for —. —. —, Solicitors for Complainants.

Marshal's Return on Equity Subpoena.

Filed April 1, 1922.

Subpoenas received at Raleigh, N. C., March 31st, 1920. Executed at Raleigh, March 31st by leaving copy with A. D. Watts, W. F. Moody for B. R. Lacy, E. H. Baker, for Baxter Durham, Frank Nash for J. S. Manning, and Frank Nash, Asst. Atty. General.

R. W. WARD,

Marshal,

By W. W. UTLEY,

Deputy.

Fees, \$10.00.

Application for Interlocutory Injunction.

Filed April 15, 1922.

In the District Court of the United States for the Eastern District
North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY
against

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.

Comes the above named plaintiff and shows the court:

That it has instituted in this court by Bill of Complaint an action against A. D. Watts, as Commissioner of Revenue of the State of North Carolina, and other defendants as shown in said bill which is now referred to and made a part of this application, the object and purpose of the action being to secure from this Honorable Court an order enjoining preliminarily and perpetually the defendants, who are tax assessing, collecting and enforcing officers, of the State of North Carolina, from collecting or instituting proceedings to collect an income tax on the net operating revenue of complainant under statutes which complainant alleges to be violative of the Constitution of North Carolina and of the Constitution of the United States. The bill alleges and sets forth the grounds of unconstitutionality of the said income tax and of the statutes of North Carolina under which said tax is assessed and under which it will be collected by the defendants named in said bill, unless restrained by this Honorable Court, all of which is more fully alleged, set out and explained in the bill of complaint filed herein. Complainant alleges that said income tax is invalid and the statutes under which it is levied are in contravention of the Constitution of North Carolina, and the Constitution of the United States, and unless the defendants are restrained and enjoined from doing so, they will proceed on and after March 15th, 1922, to levy and collect said tax.

29

Wherefore, application is made under Section 266 of the Judicial Code for an interlocutory injunction as prayed for in said bill, and this court is petitioned to call to his assistance to hear and determine this application two other judges, and that the statutory notice of the hearing of this application be given the Governor and the Attorney General of the State of North Carolina, and each of the defendants to the said bill, and an order issued requiring the defendants to show cause at the time and place to be fixed by the court according to law why said interlocutory injunction should not issue as prayed for.

This application is based upon the verified Bill of Complaint on file herein.

THOS. W. DAVIS,
Solicitor for Complainant.

GEO. B. ELLIOTT,
SKINNER & WHIEDBEE,
Of Counsel.

Filed March 30th, 1922, at Wilson.
H. G. CONNOR, *Judge.*

Order of Application for Interlocutory Injunction.

Filed April 15, 1922.

in the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY

against

A. D. WATTS, Commissioner of Revenue of North Carolina, et als.

This application for an interlocutory injunction was presented to me this 30th day of March, 1922, and having read and considered the verified bill filed in this cause, and the application for interlocutory injunction under Section 266 of the Judicial Code, and being advised that for the reasons set forth in said application and upon the grounds stated therein and in the verified bill, complainant is entitled to have its application heard under Section 266 of the Judicial Code:

It is ordered that the application be filed and a hearing of the application for an interlocutory injunction be had and proceeded with in accordance with Section 266 of the Judicial Code as amended by Act of Congress approved March 14th, 1913, and such hearing is set down for — day of March, 1922, at the United States Court Rooms in the city of Raleigh, North Carolina, at — o'clock, — M.

It is further ordered that notice of said hearing, not less than five days, shall be given to the Governor and Attorney General of the State of North Carolina, and to each of the defendants. And I hereby call to my assistance at the hearing of said application the Honorable Edmund Waddill, Circuit Judge of this Circuit, and the Honorable James E. Boyd, District Judge of the Western District of North Carolina.

This 30 day of March, 1922, at Raleigh, North Carolina.

H. G. CONNOR,
U. S. District Judge.

31 *Notice of Hearing of Application for Interlocutory Injunction*

Filed Apr. 15, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY

against

A. D. WATTS, COMMISSIONER OF REVENUE OF NORTH CAROLINA
et als.

To Honorable Cameron Morrison, Governor of the State of North Carolina; Honorable James S. Manning, Attorney General of North Carolina; Honorable Frank Nash, Assistant Attorney General of North Carolina; Honorable A. D. Watts, Revenue Commissioner of the State of North Carolina; Honorable Baxter Durham, Auditor of the State of North Carolina, and Honorable Benjamin R. Lacy, Treasurer of the State of North Carolina:

You, and each of you, are hereby notified that the Atlantic Coast Line Railroad Company, complainant, has filed its verified Bill of Complaint in the District Court of the United States for the Eastern District of North Carolina against A. D. Watts, Revenue Commissioner, et als., praying an injunction against the named tax assessing, collecting and enforcing officers of the State of North Carolina from instituting proceedings to collect an income tax upon complainant's net operating revenue under the Income Tax Act of 1921 of North Carolina, and also praying that the laws of North Carolina levying said tax be declared unconstitutional, as will appear from the bill filed herein.

In this case plaintiff has made application for an interlocutory injunction under Section 266 of the Judicial Code of the United States.

The application for such interlocutory injunction will be heard in the United States District Court, in the City of Raleigh, North Carolina, on the — day of March, 1922, at — o'clock — M., and you, and each of you, are notified to appear at said time and place and show cause, if any, why the interlocutory injunction prayed for should not be granted.

Done in open court this 30 day of March, 1922.

H. G. CONNOR,

U. S. District Judge.

Service accepted

JAMES S. MANNING,

Attorney General of N. C.

Extract from the Minutes of the Court, April 15, 1922.

In the District Court of the United States for the Eastern District
of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY

vs.

A. D. WATTS et al.

Present: The Honorable Henry G. Conner, Judge of the District
Court for the Eastern District of North Carolina.

Order.

"It is ordered that this cause be set down for final hearing on its
merits on Monday, June 13, 1922, Counsel for Plaintiff and De-
fendants being in open Court and assenting thereto; application for
Interlocutory Injunction being waived by Counsel for Plaintiff."

Answer.

Filed April 19, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

v.

A. D. WATTS, Commissioner of Revenue of North Carolina; Ben-
jamin R. Lacy, State Treasurer of North Carolina; Baxter Dur-
ham, State Auditor of North Carolina; James S. Manning,
Attorney-General of North Carolina, and Frank Nash, Assistant
Attorney-General of North Carolina, Defendants.

Answer.

To the Honorable H. G. Connor, Judge of the District Court of the
United States for the Eastern District of North Carolina:

The defendants above named, answering the bill herein, respect-
fully show the Court that:

1. In answer to Article I of the complaint, the defendants aver that, though the complainant is a corporation, organized under the laws of Virginia, it is also a domestic corporation of the State of North Carolina, organized as such under Chapter 294, Private Laws of 1893; Chapter 105, Private Laws of 1899, and Chapter 77, Public Laws of 1899. The complainant accepted the benefits conferred upon

34 it by the private acts above referred to, and also those contained in the above quoted act of 1899, the railroads in North Carolina permitted by the General Assembly to consolidate with it having become under these acts a part of its system, and thus absorbed by it; and said complainant cannot now be heard to say that it is not bound by the restrictive provisions while it holds to the benefits conferred by those acts. Since the enactment of the statutes above mentioned, and the acceptance by the complainant of the benefits thereunder, it has been uniformly held by the Supreme Court of North Carolina to be a corporation of this State.

As to the allegation in Article I in regard to the mileage and proportionate mileage, in the State of North Carolina, of the complainant, the defendants have not sufficient information to form a belief, it not having filed with the Commissioner of Revenue its return for income tax.

2. Article II is admitted, except as to the individual residence of the Assistant Attorney-General, which is in Raleigh, North Carolina.

3. It is admitted that the amount in controversy herein, exclusive of interest and cost, exceeds the sum of \$3,000. But defendants expressly deny that complainant has any equity to enjoin defendants from collecting the income tax attacked by said complainant; that said railroad company will be deprived of any privilege guaranteed and secured to it by the Constitution of the United States and the Fourteenth Amendment thereof; that it will be deprived of its property without due process of law; that it will be denied the equal protection of the law in contravention of the Constitution of the United States and the Fourteenth Amendment thereof, and that the taxes sought to be imposed by virtue and under the authority of the North Carolina statute constitute a direct burden upon interstate commerce, in violation of the commerce clause of the Federal Constitution.

4. Article IV of the bill is admitted.

5. Article V of the bill is admitted.

6. Article VI of the bill is admitted.

7. Article VII of the bill is admitted.

35 8. Article VIII of the bill is admitted.

9. Article IX of the bill is admitted.

10. Article X of the bill is admitted.

11. Article XI of the bill is admitted.

12. Article XII of the bill is denied. Further answering said article, defendants respectfully show the Court:

(a) The income-tax provision of the Constitution of the State of North Carolina, quoted in Article IV of the bill, authorizes the Legislature to determine what shall be the net income to be taxed thereunder, and expressly prohibits the allowing of any deduction for living expenses. The statute, enacted by the General Assembly of 1921, in pursuance of such constitutional authority, Chapters 34 and 35 of the Public Laws of 1921, classifies income-tax payers as follows, providing for each class a different method for ascertaining taxable incomes: first, resident individuals; second, nonresident individuals, Section 200; third, resident corporations; fourth, nonresident corporations, Section 201; fifth, railroads and other public-service corporations having their lines wholly within the State; and sixth, railroads and other public-service corporations having their lines partly within the State and partly without; and the defendants are advised, and so aver, that such classification does not in any way offend against any provision of the State or Federal Constitution. No one of these classes is allowed the same deduction or exemption as those allowed to the other classes, and in each case the distinctions made are made on account of an inherent difference between the classes themselves.

(b) The statute itself (Section 202) provides the method by which the net income of railroads is to be ascertained. It declares that, as to such railroads operating wholly in the State, the net income shall be "the net operating income" as shown by their records, kept in accordance with the standard classification of accounts of the Interstate Commerce Commission. As to railroads, when their business is part within and part without the State, it declares their net income within the State shall be ascertained by taking their gross "operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business, and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the sum so found, they are allowed to deduct "uncollectible revenue" and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, etc., and the balance shall be deemed to be their net income taxable under this act. The method thus provided by the General Assembly for ascertaining the net income of such railroads, as defendants are advised and aver, is both legally and constitutionally a proper one to apply to them, and does not offend against the interstate commerce clause of the Federal Constitution.

(c) That deductions and exemptions are allowed individuals which are not allowed ordinary corporations or railroads, and that deductions are allowed ordinary corporations which are not allowed

railroads, in specific terms, arises from the necessity to classify income-tax payers so as to arrive at their net income, and that necessity arises from differences inherent in the various businesses thus classified. Without such classification, defendants are advised and believe, it would be impossible to levy a fair and just income tax. Defendants are advised and believe that, in applying the method provided in the act, many deductions are necessarily allowed, besides those specifically set out in Section 202, "uncollectible revenue," and taxes paid in this State for the income year, etc., i. e., wages of employees, salaries of officers, if reasonable in amount, for services actually rendered in producing such income, and others too numerous to incorporate in this answer. A list of them is hereto attached, marked "Exhibit A," and is asked to be taken as part of this answer. It is admitted that complainant has copied correctly Section 306 of the Revenue Act in subsection (c) of Article XII of its bill, 37 but it is expressly denied that there has been any discrimination against railroads and in favor of ordinary business corporations.

13. Article XIII of the bill is not true as stated, and so is denied. If there are any such corporations, and the defendants, on information and belief, deny that there are such, they would pay income tax under other provisions of the statute.

14. Article XIV of the bill is not true as stated, and so is denied. It is admitted that interest paid during the tax year on outstanding bonded and other indebtedness is not one of the deductions allowed to railroads, whereas it is allowed to individuals and business corporations, but many other deductions are allowed to railroads which are not allowed to either individuals and business corporations. See Exhibit A. Defendants are informed and believe, and so aver, that the method of financing railroads is so wholly different from that of other corporations that they are necessarily in a class to themselves with other public-service corporations, and that a refusal, under such circumstances, to permit a deduction for interest on their bonded indebtedness is justified and is not a discrimination against them. The statute (Section 306, subsection 3) expressly prohibits the deduction of dividends on preferred stock to business corporations.

15. Article XV of the bill is not true as stated, and so is denied. It is expressly averred that the Income Tax Act of 1921 does operate equally and uniformly upon all taxpayers in similar circumstances, and that the variations in its operation are caused by the differences in the character of the objects upon which it operates, and it does in effect classify these various objects to meet these differences, and so the complainant is not denied the equal protection of the law and is not deprived of its property without due process of law in contravention of the Fourteenth Amendment to the Constitution of the United States. The process of arriving at the net income earned by railroads having part of their line in the State and part out is

38 necessarily long and intricate. The General Assembly, knowing this, and knowing also that the simplest way of arriving at such a net income was by using as a basis the records required to be kept by the Interstate Commerce Commission, adopted that plan, and declared in Section 202 what should be the net income of such corporations in its application to them. Defendants deny that this classification is either unreasonable or arbitrary, and aver that instead it is based upon an evident distinction in the classes, and is valid and constitutional.

16. Article XVI of the bill is not true as stated, and so is denied. The Constitution of North Carolina, no less than the Federal Constitution, permits classification in a proper case, and defendants aver that the classification in the income-tax law is both just and necessary to comply with the Constitution of the State that such taxes should be uniform.

17. Article XVII of the bill is not true as stated, and so is denied.

18. Article XVIII of the bill is not true as stated, and so is denied. The defendants affirm that the Income Tax Act of 1921 does apply to railroads and public-service corporations deriving their income from sources other than the operation of their property.

19. Article XIX of the bill is not true as stated, and so is denied. Section 3, Article V of the State Constitution, expressly authorizes the General Assembly, at its discretion, to tax incomes. If it does determine to tax incomes, it may not in any case exceed 6 per cent; it may not in any case decrease the minimum amount of exemption allowed to individuals. It may allow other deductions, not including living expenses, so that net incomes are taxed. With these limitations, then, the Legislature has authority to determine what is net income.

20. Article XX of the bill is not true as stated, and so is denied. The General Assembly has declared what shall constitute net incomes in the case of railroads, and, as appears by Exhibit A, a very large number of deductions are allowed from gross income in determining what is net income. In no sense, then, defendants aver, can a tax on such income be a tax upon a gross income or a burden on interstate commerce.

21. Article XXI of the bill is not true as stated, and so is denied. Section 202, far from prescribing a system of accounting for an interstate railroad, adopts the system partially already prescribed by Interstate Commerce Commission as a means of arriving at the net income of the complainant earned within the State of North Carolina.

22. Article XXII of the bill is not true as stated, and so is denied. It is true that the General Assembly of North Carolina, under authority conferred upon it by the amendments to the State Constitution, adopted at the general election of 1920, and which became effective January 7, 1921, declined to levy any State ad valorem tax,

but left such tax wholly to the counties and other subordinate governmental agencies of the State. It is true that it levied a franchise tax one-tenth of one per cent upon the value of railroad property in the State for the benefit of the State. It is true also that it levied an income tax of three per cent upon the net incomes of railroads and all other corporations, but defendants deny that any one or all of these methods of taxation for State purposes constitutes such taxes a burden upon interstate commerce, or violates in any sense the Constitution of the United States.

23. Article XXIII of the bill is not true as stated, and so is denied. The amendments to the State Constitution, commonly called the Taxation Amendments, were adopted at the general election of 1920, and became effective January 7, 1921. The defendants are advised and believe that such amendments authorized the General Assembly of the State to adopt the general scheme of taxation which it commenced to put into effect at the Extra Session of August, 1920, and put in full force in the Revenue Act of 1921; that a general scheme of taxation is wholly within the authority of the State, and can only be attacked when the legislation enacted in pursuance thereof, or the

administration of such taxing laws, destroys some constitutional right of the complainant; that the refusal of the State to levy an ad valorem tax upon the property of the defendant, while it permits subordinate governmental agencies to levy this tax under the rules, regulations and restrictions contained in the State Constitution, can in no sense, as defendants aver and believe, impair any constitutional right of the complainant; that the State, as defendants are advised and believe, may constitutionally levy a license or franchise tax upon complainant for the privilege of performing its functions in the State; an income tax upon income earned in the State, and also an ad valorem tax upon its property for the benefit of the State; that its refusal to levy the latter tax cannot, as defendants aver, affect the constitutionality of the levy of the franchise and income tax. Defendants particularly deny that there has been any exemption of any class of property from the general burdens of taxation, as alleged in Article XXIII of the bill, and defendants aver that the scheme of taxation of the shares in incorporated companies in the hands of the shareholders, as provided in the Revenue and Machinery Acts of 1921, has been in effect in the State for more than twenty years; said shares being taxed at the principal office of the corporation itself.

24. Article XXIV of the bill is not true as stated, and so is denied. Particularly it is denied that the Revenue Act of 1921 is in any particular retroactive or retrospective within the meaning of Section 32 of Article I of the State Constitution.

25. Article XXV of the bill is not true as stated, and so is denied. It is true that the Commissioner of Revenue has sent to complainant the form for return of income tax for the calendar year ending December 31, 1921, attached to the bill. It is admitted that he will proceed to collect, in accordance with the machinery of the law, a

proper income tax from complainant, but it is expressly denied that any greater income tax will be collected from complainant than that collected from all other public-service corporations under the same circumstances and conditions. Section 504 of the act requires
 41 the Commissioner of Revenue, when the tax is not paid within sixty days after it becomes due, to issue an order to the sheriff to collect the same. The complainant, then, is given an adequate remedy at law to recover all taxes illegally paid, in section 7979 of the C. S. of 1919, and in an act of the Extra Session of 1921, entitled "An act to refund taxes illegally collected and paid into the State treasury."

26. Article XXVI of the bill is not true as stated, and so is denied. Defendants expressly deny that the penalties set forth in Section 600 of the Income Tax Act are excessive, unreasonable, oppressive, and inequitable. Those penalties are imposed for wilful or fraudulent failure to comply with the provisions of the act, and so would not be a denial of due process of law to the complainant. The Revenue Commissioner and the Attorney-General are given authority to waive or reduce the penalties therein provided for.

Wherefore, having fully answered all the allegations of the bill herein, the defendants pray judgment:

1. That the bill be dismissed.
2. For cost of this action.
3. For such other and further relief as to the Court may seem just.

JAMES S. MANNING,
Attorney-General of North Carolina;
 FRANK NASH,

Assistant Attorney-General of North Carolina,
Solicitors for Defendants.

GEO. H. BROWN,
 WM. P. BYNUM,
 LOCKE CRAIG,
 THOS. D. WARREN,
 S. S. ALDERMAN,
Of Counsel.

42 A. D. Watts, one of the defendants, being duly sworn, says that he is State Commissioner of Revenue; that he has read the foregoing answer and knows the contents thereof; that the same is true, of his own knowledge, except as to matters therein stated on information and belief, and as to those matters he believes it to be true.

A. D. WATTS.

Sworn and subscribed to before me, this April 19, 1922.

EDWARD SEAWELL,
Deputy Clerk Supreme Court.

EXHIBIT A TO ANSWER.

1. Maintenance of Way and Structures:

Superintendence; roadway maintenance—yard; roadway maintenance—other; bridges, trestles and culverts—yard; bridges, trestles and culverts—other; ties—yard; ties—other; rail—yard; rail—other; other track material—yard; other track material—other; ballast—yard; ballast—other; track laying and surfacing—yard; track laying and surfacing—other; right of way fences—yard; right of way fences—other; crossings and signs—yard; crossings and signs—other; station and office buildings; roadway buildings; water stations; fuel stations; shops and engine houses; storage warehouses; wharves and docks; telegraph and telephone lines; signals and interlocks; miscellaneous structures; paving; roadway machines; small tools and supplies; removing snow, ice and sand; injuries to persons; insurance; stationery and printing; other expenses; maintaining joint tracks, yards, and other facilities—Dr.; maintaining joint tracks, yards, and other facilities—Cr.

2. Maintenance of Equipment:

Superintendence; shop machinery; steam locomotives—repairs; steam locomotives—depreciation; steam locomotives—retirements; freight-train cars—repairs; freight-train cars—depreciation; freight-train cars—retirements; passenger-train cars—repairs; passenger-train cars—depreciation; passenger-train cars—retirements; floating equipment—repairs; floating equipment—depreciation; work equipment—repairs; work equipment—depreciation; work equipment—retirements; injuries to persons; insurance; stationery and printing; other expenses; maintaining joint equipment at terminals—Dr.; maintaining joint equipment at terminals—Cr.

3. Traffic:

Superintendents; outside agencies; advertising; traffic associations; fast-freight lines; industrial and immigration bureaus; insurance; stationery and printing; other expenses.

4. Transportation Rail Line:

Superintendence; dispatching trains; station employees; weighing, inspection, and demurrage bureau; station supplies and expenses; yardmaster and yard clerks; yard conductors and brakemen; yard switch and signal tenders; yard enginemen; fuel for yard locomotives; water for yard locomotives; lubricants for yard locomotives; other supplies for yard locomotives; engine-house expenses—yard; yard supplies and expenses; train enginemen; fuel for train locomotives; water for train locomotives; lubricants for train locomotives; other supplies for train locomotives; engine-house expenses—train; trainmen; train supplies and expenses; signal and interlock operation; crossing protection; drawbridge operation; telegraph and tele-

phone operations; operating floating equipment; stationery and printing; other expenses; insurance; clearing wrecks; damage to property; damage to livestock on right of way; loss and damage—freight; loss and damage—baggage; injuries to persons; operating joint yards and terminals—Dr.; operating joint yards and terminals—Cr.; operating joint tracks and facilities—Dr.; operating joint tracks and facilities—Cr.

5. Transportation Water Line.

6. Miscellaneous Operations:

Dining and buffet service; salaries and expenses of general officers; salaries and expenses of clerks and attendants; general office supplies and expenses; law expenses; insurance; relief department expenses; pensions; stationery and printing; valuation expenses; other expenses; general joint facilities—Dr.; general joint facilities—Cr.

45 *Affidavit of M. S. Hawkins.*

Filed May 15, 1922.

United States District Court, Eastern District of North Carolina.

ATLANTIC COAST LINE RAILROAD COMPANY

VS.

A. D. WATTS, Commissioner of Revenue, et als.

M. S. Hawkins, being first duly sworn, deposes and says that he is Secretary of Norfolk Southern Railroad Company; that Norfolk Southern Railroad Company is a corporation originally created, organized and existing under the laws of the State of Virginia, owns and operates a line of railroad located partly in Virginia and partly in North Carolina and, in addition, during the year 1921, had, and now has, under lease a line of railroad owned by the Atlantic & North Carolina Railroad Company, extending from Goldsboro to Morehead City, and also a lease of the Durham & South Carolina Railroad, extending from Duncan to Durham, and under lease the Carthage & Pinchurst Railroad, extending from Pinchurst to Carthage;

That the line of railroad owned by the Atlantic & North Carolina Railroad Company was held under lease made by the Atlantic & North Carolina Railroad Company to the Howland Improvement Company, bearing date the 1st day of September, 1904, for a term of ninety-one years and four months from the said date, and to be fully ended and completed, commencing the 1st day of September, 1904;

That Norfolk Southern Railroad Company is the successor by assignments and mesne conveyances of said leasehold; that during the year 1921, Norfolk Southern Railroad Company duly paid the rent on said property;

That the Durham & South Carolina Railroad is held under lease bearing date of 27th day of May, 1920, and is for a term of ninety-nine years; that the rent on said property was duly paid for the year 1921;

46 That the Carthage & Pinchurst Railroad was held under lease made during the period of Federal Control of Railroads and terminated by its terms at the end of Federal Control; that Norfolk Southern Railroad Company continued to operate the same during the year 1921, until it could and did obtain authority from the Interstate Commerce Commission, under the terms of the Transportation Act of 1920, for the cessation of operation of said line of railroad, which authority was duly obtained and it ceased to operate same in January, 1922.

M. S. HAWKINS,

Sworn and subscribed to before me this 13 day of March, 1922.
[SEAL.] J. R. PRITCHARD,

Notary Public.

My commission expires Jan. 10, 1925.

47 *Affidavit of E. H. Kemper.*

Filed May 15, 1922.

United States District Court, Eastern District of North Carolina.

ATLANTIC COAST LINE RAILROAD COMPANY

VS.

A. D. WATTS, Commissioner of Revenue, et als.

E. H. Kemper, being first duly sworn, deposes and says that he is Comptroller of Southern Railway Company; that Southern Railway Company is a corporation originally created, organized and existing under the laws of the State of Virginia, owns and operates a line of railroad located partly in Virginia and partly in North Carolina, and partly in other states, and, in addition, during the year 1921, had, and now has, under lease certain lines of railroad wholly in the State of North Carolina and certain lines of railroad partly in the State of North Carolina, as follows:

(a) Owned by—North Carolina Railroad, extending from Goldsboro to Charlotte, N. C.; Raleigh, N. C. Entrance Union Station and Caraleigh Junction, N. C., to Caraleigh, N. C. held under lease bearing date of August 16, 1895, for a term of ninety-nine years from January 1, 1896.

(b) Owned by—Atlanta & Charlotte Air Line Railway Company, extending from Charlotte, N. C., to Armour, Ga., held under lease dated March 26, 1881, the agreement to remain in force as long as lessee fulfills its obligations thereunder.

(c) Owned by—Atlantic & Danville Railway Company, extending from Danville, Va., to West Norfolk, Va.; Shoulders Hill, Va., to Portsmouth, Va.; Shops, Va., to Portsmouth, Va.; James River Jet., Va., to Claremont Wharf, Va.; Hitchcock Branch Jet., Va., to Buffalo Junction, Va., to Buffalo Lithia Springs, Va.; held under lease bearing date of August 31, 1899 for a term beginning September 1, 1899, and ending July 1, 1949.

(d) Owned by—North and South Carolina Railroad Company, extending from N. & S. C. Junction to Mines, N. C.; held under lease bearing date August 31, 1899.

(e) Owned by—Southern Railway—Carolina Division, extending from Kingville, S. C., to Marion, N. C.; Sumter Jet., S. C., to Sumter, S. C.; Blacksburg, S. C., to Gaffney, S. C.; Branchville, S. C., to Columbia, S. C.; Biltmore, N. C., to Hayne, S. C.; Hendersonville, N. C., to Lake Toxaway, N. C.; Spartanburg, S. C., to Alston, S. C.; Charleston, S. C., to Savannah River, near Augusta, Ga.; Burton Branch, S. C.; Cayce, S. C., to Hardeeville, S. C.; Perry, S. C., to Seivern, S. C. Held under lease bearing date June 30, 1902, for a term of 999 years, beginning July 1, 1902.

(f) Owned by—North Carolina Midland Railroad extending from Mooresville Junction, N. C., to Winston-Salem, N. C., bearing date of February 5, 1916, and extended for a term to run and continue after December 31, 1920, until the expiration of 30 days in writing by either party to the other of the election to terminate such lease.

(S.)

E. H. KEMPER.

Sworn and subscribed to before me this 15th day of March, 1922.

[SEAL.]

(S.)

J. C. NAUGHTEN,

Notary Public.

Affidavit of J. H. Bridgers.

Filed May 15, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, and Others, Defendants.

J. H. Bridgers, being duly sworn, says: That he is President of Henderson Water Company, a corporation incorporated under the

laws of the State of North Carolina, and engaged in the business of supplying water to the public in the town of Henderson, N. C.; that the said corporation is engaged in public service. That the said corporation is not required to and does not keep its records according to the standard classification of accounting of the Interstate Commerce Commission. That after making the deductions allowed it under the Income Tax Act of North Carolina of 1921, the said company has no taxable income. That there is attached to this affidavit and made a part hereof a duplicate of the income tax return filed by the Henderson Water Company with the Commissioner of Revenue of North Carolina, as required by the Income Tax Act of North Carolina of 1921, upon which said return it appears that the said company after making the deductions allowed corporations under the provisions of the said Income Tax Act, the Henderson Water Company has no taxable income. That there is also attached hereto and made a part of this affidavit a form for income tax return by corporations designated in Section 202 of the Income Tax Act, which has been filled out from the books of the Henderson Water Company and which correctly shows the amount of taxable income upon which the said company would be required to pay the income tax if it came within the corporations designated by said Section 202 and was required to keep its accounts according to the standard classification of accounting of the Interstate Commerce Commission, and from which it appears that said corporation would be required to pay an income tax of \$167.21, if its income taxable under the law were required to be determined on the basis of said return.

(S.)

J. H. BRIDGERS.

Sworn and subscribed to before me this 14th day of March, 1922.

(S.)

J. A. SCOTT,

Notary Public.

My commission expires 2nd day of May, 1922.

50

EXHIBIT "A."

Copy.

State Department of Revenue.

Public-service Corporation Income Tax Return Other Than Railroads.

For Calendar Year Ending December 31, 1921.

Name and kind of business, Henderson Water Company.
Business address, Henderson.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return

made in good faith, for the taxable period as stated, pursuant to the Revenue Act for 1921 and the Regulations issued under authority thereof.

_____,
President.

_____,
Treasurer.

Sworn to and subscribed before me, this — day of —, 1922.

_____,
(Official capacity.)

Operating Revenues, in this State, including mileage proportion of interstate business as per standard Classification of Accounts of Interstate Commerce Commission	\$32,101.83
Operating Expenses, as per standard Classification of Accounts of Interstate Commerce Commission	26,079.00
Net operating revenue	\$6,022.00
All other income .....	.....
Total income	\$6,022.00
Less taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes	771.00
Net taxable income	\$52.41
Tax @ 3%	\$167.23

31 Railroad and Public-service Corporations; Basis of Ascertaining Net Income.—The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the "net operating income" of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross "operating revenues" within this State, including in their gross "operating revenues" within this State the equal mileage proportion within this State of their interstate business and deducting from their gross "operating revenues" the proportionate average of "operating expenses," or "operating ratio," for their whole business, as shown by the Interstate Commerce Commission standard classification of

accounts. From the net operating income thus ascertained shall be deducted "uncollectible revenue," and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act.

Car Hire Considered.—In determining the taxable income of a corporation engaged in the business of operating a railroad under the preceding section, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire; and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire.

Copy.

Form 3.

State Department of Revenue.

Corporation Income Tax Return.

For Calendar Year Ended December 31, 1921.

(Make Affidavit on This Page for Either Blank.)

Kind of business, Henderson Water Company—Public Water Supply.
Business address, Henderson, N. C.

We, the undersigned, president and treasurer of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return, including the accompanying schedules and statements, has been examined by him and is, to the best of his knowledge and belief, a true and complete return made in good faith, for the taxable period as stated, pursuant to the Revenue Act for 1921 and the Regulations issued under authority thereof.

(S.)

J. H. BRIDGERS,

President.

(S.)

J. H. BRIDGERS,

Treasurer.

Sworn to and subscribed before me, this 10 day of Mar., 1922.

_____,
(Official capacity.)

Corporation Income Tax Return.—Continued.

What was the net income for the calendar year 1921 returned to the U. S. Government before taking off any exemption allowed by the Federal law or State income tax		\$	None.
Bad debts charged off in Federal return and not deductible in this return		\$	None.
Total		\$	.....
Deduction.			
Dividends not taxable by State, included in Federal return			.....
Net income under State law, all of which is taxable		\$	.....
Tax at 3 per cent.		\$	None.

If Above Form Is Used, It Is Not Necessary to Fill Out This Form.

Gross Income.

1. Gross sales less returns and allowances	\$	.....
Plus inventory close of year		.....
2. Less cost of raw materials	\$	.....
.....	
.....	
.....	
.....	
Wages and labor		.....
Total raw materials, wages and labor	\$	.....

This Inventory Beginning Sent

Plus inventory beginning year.....	\$.....
Gross income from operation.....	32,101.83
3. Gross income from operations other than trading or manufacturing.....	\$.....
4. Taxable interest received from all sources.....	.....
5. Rentals.....	.....
6. Royalties.....	.....
7. Income received from partnership.....	.....
8. Total dividends received from foreign corporations, no part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each.....	.....
9. Total dividends received from foreign corporations, part of which corporation's income is subject to income tax under the State law. Attach statement showing names of corporations and amount received from each.....	.....
10. Gross income from all other sources subject to tax.....	.....
11. Total income, 3 to 10.....	.....
12. Total gross income, 1 to 11.....	\$.....

Corporation Income Tax Return.—Continued.

53

Deductions.

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business	\$
2. Reasonable compensation of officers.....	.....
3. Rentals or other payments required to be made as a condition of the continued use or possession, for the purpose of the trade of property to which the taxpayer has not taken, or is not taking title, or in which he has no equity.....	.....
4. All interest paid during the income year on indebtedness, except interest on obligations contracted for the purchase of nontaxable securities. Dividends on preferred stock shall not be deducted as interest.....	.....
5. Taxes for the income year, except taxes on income and war profits and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.....	.....
6. Dividends from stock in any corporation the income from which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only a part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted. Attach statement of such dividends.....	.....
7. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.....	.....
8. Debts ascertained to be worthless and charged off within the taxable year if the amount has previously been included in gross income in a return under this act.....	.....

[illegible]

Corporation Income Tax Return.—Continued.

55

Reconciliation of Net Income and Analysis of Changes in Surplus.

Column 1.		Column 2.	
1. Net income from line —, page —	\$	4. Unallowable Deductions	\$
Nontaxable Income:		(a) Income and profits taxes paid to the U. S., its possessions or foreign countries . . . . .	.....
(a) Interest on obligations of the United States and its possessions wholly exempt . . . . .	.....	(b) Life insurance premiums on lives of officers . . . . .	.....
(b) Interest on obligations of State of N. C. . . . .	.....	(c) Income taxes paid to State of North Carolina . . . . .	.....
(c) Dividends on stock of N. C. corporations subject to N. C. income tax . . . . .	.....	(d) Special improvement taxes tending to increase the value of the property assessed . . . . .	.....
(d) Difference between book profit on sale of capital assets and as shown herein . . . . .	.....	(e) Furniture and fixtures, additions, or betterments treated as expense on the books . . . . .	.....
(e) Charges against reserves for bad debts, contingencies, etc. (to be detailed) . . . . .	.....	(f) Renewals and replacements . . . . .	.....
(a) . . . . .	.....	(g) Interest paid to purchase nontaxable securities . . . . .	.....
(b) . . . . .	.....	(h) Additions to reserves: . . . . .	.....
	
	

(c) .....	.....	Other Unallowable Deductions:	.....
3. Surplus and undivided profits as shown	.....	.....	.....
by balance sheet at close of preced-	.....	.....	.....
ing taxable year.....	.....	.....	.....
Other Credits to Surplus:	.....	5. Dividends paid during taxable year..	.....
.....	.....	(a) Date paid .....	.....
.....	.....	Character .....	.....
.....	.....	Date paid .....	.....
.....	.....	Character .....	.....
.....	.....	Date paid .....	.....
.....	.....	Character .....	.....
.....	.....	Date paid .....	.....
.....	.....	Character .....	.....
.....	.....	Other Debits to Surplus to be Detailed:	.....
.....	.....	(a) .....	.....
.....	.....	(b) .....	.....
.....	.....	(c) .....	.....
.....	.....	Total Column 2.....	\$.....
Total Column 1.....	\$.....		
Surplus and undivided profits shown by			
balance sheet close of year—Column			
1 minus Column 2.....	\$.....		

Affidavit of H. C. Prince.

Filed May 15, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Affidavit of H. C. Prince.

STATE OF NORTH CAROLINA,

County of New Hanover:

Personally appeared before me, a Notary Public, in and for the State of North Carolina and County of New Hanover, H. C. Prince, a resident of the aforesaid State and county, who, upon being duly sworn, deposes and says that:

1. He is Comptroller of the Atlantic Coast Line Railroad Company and has occupied that position since July 1, 1902, (except from July, 1918, to February 29, 1920), and as such Comptroller he prescribed the accounting methods of said railroad company and directed and supervised its accounts in accordance with such methods. From July, 1918, to February 29, 1920, he was Federal Auditor for the United States Railroad Administration and as such directed the accounting for the operations of the Atlantic Coast Line Railroad Company's properties, which during that period were operated by the United States Railroad Administration; that he is an expert accountant and is thoroughly familiar with accounting.

2. He has read the Bill of Complaint and the Answer filed in this cause and the sections of the Income Tax Law of 1921 of North Carolina in reference thereto.

3. Affiant attaches hereto the Classification of Income Profit Loss and General Balance Sheet Account for Steam Roads prescribed by the Interstate Commerce Commission, in accordance with section 29 of the Act of Congress to Regulate Commerce, effective on July 1, 1914, and which is now and has been in effect since July 1, 1914, which said Classification is marked Exhibit "A."

4. Affiant also attaches hereto Classification of Operating Revenues and Operating Expenses of Steam Roads prescribed

by the Interstate Commerce Commission in accordance with section 209 of an Act to Regulate Commerce effective July 1, 1914, and which has been in effect since that date and is now in effect, which said Classification is marked Exhibit "B."

5. Affiant further says that he is thoroughly familiar with the Classification of Accounts of the Interstate Commerce Commission, and has been so familiar for many years, and that there is no such designation in the Classification of Accounts of the Interstate Commerce Commission as "net railway operating income."

6. Affiant further says that if "net railway operating income" is to be construed as that income defined as such in section 1 of the Federal Control Act, Section 15-a of the Interstate Commerce Act and Section 209 of the Transportation Act, 1920, then the basis of ascertaining such "net railway operating income" of a railroad wholly within the State of North Carolina differs, under the Act from the method provided in the Act, for ascertaining such income for railroads whose business is partly within the State and partly without the State, for that those railroads whose business is partly within and partly without the State are not allowed deductions from their gross operating income, which items are allowed railroads wholly within the State, and which items are as follows:

Locomotive hire,
Working equipment hire,
Floating equipment hire, and
Joint facility rents,

all of which accounts are fully set forth in the Classification of Accounts attached hereto. Therefore, in making up the return for taxes for public service corporations described in Section 202 of the Income Tax Act of 1921 whose lines are wholly within the State of North Carolina, these companies necessarily are entitled under the law to these deductions and necessarily will pay a smaller rate of income than a public utility company doing business within and without the State of North Carolina, and to the extent to which these deductions are made there is an actual discrimination against the corporation whose lines are partly within and partly without the State.

7. Affiant further says that under all rules of accounting net income is, as a matter of fact, that amount received by a corporation after the deduction from its gross income of all of the expenses of operating its property which expenses necessarily include such items as rentals paid for property used in earning said income, and interest paid on indebtedness on such property used in earning said income.

H. C. PRINCE.

Subscribed and sworn to before me this 13th day of May, 1922.

[SEAL.]

BERTRAM QUELCH,

Notary Public.

My commission expires May 31st, 1922.

59 In the District Court of the United States for the Eastern District of North Carolina.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.
Defendants.

Affidavit of Nathan O'Berry.

Filed May 23, 1922.

Nathan O'Berry, being first duly sworn, deposes and says:

1. That he is a citizen and resident of the State of North Carolina and County of Wayne, that he is President of Enterprise-Whiteville Lumber Company.

2. That said company is an industrial corporation engaged in operating lumber mills located respectively at Whiteville and Mt. Olive, North Carolina.

3. That said company, as a part of its business constructed a line of railroad extending from Whiteville, N. C., to Butlers, N. C., a distance of about 27 miles, and also constructed a line of railroad extending from Mt. Olive, N. C., to New Camp, N. C., a distance of about 18 miles.

4. That said railroads were established and maintained solely by the owner of the lands upon which the said roads were constructed and the principal business of said railroad is the transportation of logs, lumber and other articles of the owners of said railroad.

5. Acting under the provisions of section 3413 of the Consolidated Statutes of North Carolina, the said corporation applied to the Corporation Commission of North Carolina for authority to to said corporation to transport between the termini of said two lines of railroad, commodities other than that owned by the said lumber company, and for authority to charge therefor reasonable rates to be approved by said corporation.

6. The Corporation Commission, under the powers vested in it under said section 3413 of the Consolidated Statutes of North Carolina, duly authorized the said corporation to act as a common carrier between the termini of its said two lines of Railroad and established a scale of rates which said corporation might charge for the transportation of the kind and character of commodities which it was authorized to transport for others for such services.

7. That the said Corporation does not have any Tariff filed with Interstate Commerce Commission, and is not authorized to and does not engage in the transportation of freight or passengers in interstate

commerce, or between any points other than those on its own line. That the said corporation, during the year 1921, paid interest on account of money borrowed, that the said corporation in making its income tax returns to the Commission of Revenue of the State of North Carolina, deducted from its gross income the interest so paid in order to arrive at its net income, this deduction being made in addition to the other deductions allowed under section 306, schedule D of the Revenue Act of North Carolina.

8. This affiant is informed and believes that it was entirely proper under the laws of North Carolina for said corporation to deduct the interest paid during the year 1921 from its gross income in order to ascertain the net income subject to tax.

(S.)

NATHAN O'BERRY.

Sworn and subscribed to before me this 17th day of May, 1922.

[SEAL.]

C. W. BRINKLEY,
Notary Public.

My Commission expires January 24th, 1924.

Affidavit of A. R. Turnbull.

Filed May 23, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

A. R. Turnbull, being first duly sworn, deposes and says:

1. That he is President of the Rowland Lumber Company.

2. Rowland Lumber Company is a corporation duly organized and existing under the laws of the State of North Carolina, the principal business of the said company is the manufacture of lumber.

3. That it operates a large mill in North Carolina, located at New Bern, and has under lease a line of railroad extending from Clarks Junction, a point on the Atlantic & North Carolina Railroad, westwardly to and beyond New River and thence to Chinquapin, and a few miles beyond, where it connects with a line of railroad owned by Rowland Lumber Company, which extends to Kenansville, where it connects with a line of railroad owned by Atlantic & Carolina Railroad Company.

4. The principal business of the said railroad running from Kenansville to Clarks Junction, through Chinquapin is the transportation of logs and lumber for the owner of such railroad.

5. The Corporation Commission of North Carolina, acting under the power vested in it by section 3413 Consolidated Statutes of North Carolina, has granted to Rowland Lumber Company authority to transport commodities of certain kinds and character other than those owned by the said Rowland Lumber Company over that part of the said line of railroad between Kenansville and Chinpuapin and to charge therefor a scale of rates fixed and established by the Corporation Commission of North Carolina.

6. Rowland Lumber Company does transport for others than itself commodities of the kind and character authorized by said authority to be transported and charges therefor the scale of rates authorized by the Corporation Commission.

62 7. That the Rowland Lumber Company is not engaged in interstate commerce and has never filed any tariffs with the Interstate Commerce Commission, and has not been authorized to engage in interstate commerce, and is prohibited under the law from so doing until it has filed tariffs with the Interstate Commerce Commission as required by the Interstate Commerce Act.

8. That during the calendar year 1921, which is the income tax year for 1921 in the state of North Carolina, Rowland Lumber Company paid rent for the line of railroad operated by it as aforesaid and also paid other rents for properties used in its said business and to which it had not taken and was not taking title, and to which it had no equity except its leasehold, and also paid sums as interest for money borrowed and used in its business.

9. Affiant is informed and believes that Rowland Lumber Company is, under the income tax law of North Carolina, schedule D of Chapter 34, entitled to deduct the amounts so paid as interest and rent, together with other deductions allowed by said schedule from its gross income, in order to arrive at its net income subject to tax under the said tax laws of North Carolina.

10. That the said railroad is of standard gauge and can and does receive cars from other lines of railroad, which it transports to destination on its own line.

(S.)

H. R. TURNBULL

Sworn and subscribed to before me this 20th day of May, 1922

[SEAL.]

J. E. DAY, JR.,
Notary Public.

Commission expires Sept. 18, 1923.

Affidavit of C. D. Bradham.

Filed May 25, 1922.

In the District Court of the United States for the Eastern District
of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.*Affidavit of C. D. Bradham.*

C. D. Bradham, being first duly sworn, deposes and says that he is President of the Atlantic & North Carolina Railroad Company; that prior to the year 1921, the Atlantic & North Carolina Railroad Company leased to the Howland Improvement Company its line of railroad, extending from Morehead City to Goldsboro, North Carolina.

That the Norfolk Southern Railroad Company is the successor in title to the said leasehold interest granted by said lease and during the year 1921 was in possession of said line of railroad under said lease and used the same exclusively and conducted and carried on the business of a common carrier over said line of railroad.

That during the said year 1921, Norfolk Southern Railroad Company paid the Atlantic & North Carolina Railroad Company the amount of rent required by said lease to be paid for the continued use of said property in the trade or business of Norfolk Southern Railroad Company; that the payment of the said rent was a condition precedent to the continued use of the said property by the Norfolk Southern Railroad Company in its business.

That the Norfolk Southern Railroad Company has not taken title to the said property, was not taking title thereto, and has no equity in the property owned by the Atlantic & North Carolina Railroad Company.

That under the terms of the said lease, Norfolk Southern Railroad Company, as Lessee, is required to pay any income tax levied upon the income of the Atlantic & North Carolina Railroad Company derived from or under said lease.

That the amount of money received from Norfolk Southern Railroad Company as rent for the use of said property is substantially the entire income of the Atlantic & North Carolina Railroad Company.

C. D. BRADHAM.

Subscribed and sworn to before me this 24 day of May, 1922.

[OFFICIAL SEAL.]

S. E. LANCASTER,
C. C. Court, Craven County.

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Affidavit of Charles J. Joseph.

Filed May 25, 1922.

In Equity.

No. 448.

In the District Court of the United States for the Eastern District of
North Carolina.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Affidavit of Charles J. Joseph.

STATE OF NORTH CAROLINA,
County of New Haven:

Charles J. Joseph, being first duly sworn, deposes and says:

1. That from 1900 to 1902 he was Real Estate Agent and Tax Agent of the Plant System of Railroads, in charge of the States of Georgia, Florida and Alabama; that from 1902, when the Plant System of Railroads was sold to and merged into the Atlantic Coast Line Railroad Company, a Virginia corporation, he was Tax Agent of the Second and Third Divisions of the Atlantic Coast Line Railroad Company, in charge of the States of Georgia, Florida and Alabama, and a part of South Carolina; that from 1907 to date, he has been Tax Agent of the entire system of the Atlantic Coast Line Railroad Company, in charge of the States of Virginia, North Carolina, South Carolina, Georgia, Florida and Alabama; that from 1883 to 1900 he was civil engineer and chief clerk to Superintendent of the Florida Southern Railroad Company, Savannah, Florida and Western Railroad Company, and the Plant System of Railroads, at various periods of time; that his duties as such Real Estate Agent and Tax Agent were to return for taxation the properties of such railroads, in the several states traversed by them, and to appear before the tax boards of the said States in the matter of the assessments of properties of said railroads.

2. That he has read the Bill of Complaint in this cause and is familiar with the facts set forth therein, and with this litigation.

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3. That the North Carolina Tax Commission in the years 1919 and 1920 and the Commissioner of Revenue of North

Carolina in the year 1921 assessed the property of the Atlantic Coast Line Railroad Company in North Carolina for ad valorem purposes, as follows:

Year.	Tangible assessment.	Intangible assessment.	Total assessment.
1919	\$15,891,000	\$18,754,345	\$34,645,345
1920	39,620,930	11,246,870	50,867,800
1921	39,916,847	11,246,870	51,163,717

4. That the said assessment was used not only for advalorem taxes but also as a basis for a tax called a franchise tax of one tenth of one per cent payable to the State, which tax was paid by the Atlantic Coast Line Railroad Company in 1920 under protest.

5. That in September, 1921, the Atlantic Coast Line Railroad Company brought suit to have declared said so-called franchise tax unconstitutional and to have the said ad valorem assessment declared invalid and reduced.

6. That by stipulation made in October, 1921, in said suit, Atlantic Coast Line Railroad Company paid ad valorem tax based upon an assessment of \$34,645,345, amounting in the aggregate to the sum of \$455,516.64 which was \$89,768.74 more than the tax it paid for the year 1920.

7. That if the said assessment which is being contested in said suit so brought and which is now pending in the Supreme Court of the United States is declared valid, the Atlantic Coast Line Railroad Company will have to pay to the State of North Carolina for ad valorem taxes for the year 1921, to the various counties, cities and subdivisions, in addition to the taxes already paid for the year 1921, the sum of approximately \$179,000.00, and if the said so-called franchise tax of one tenth of one per cent is sustained, it will have to pay an additional tax of \$51,163.00, making a total of \$230,163.00 additional taxes. In addition to which, if the said income tax, which is being contested in this suit, is declared valid and the construction placed upon said statute by the Commissioner of Revenue is sustained, and said railroad company made to pay in accordance with the form attached to the Complaint, Marked Exhibit "A," an additional tax will have to be paid by the Atlantic Coast Line Railroad Company amounting to \$41,686.96.

8. The ad valorem tax is based, not only on real and personal property, but upon the intangible value of the property of this company as found by said Commissioner of Revenue, in addition to which the said franchise tax is also based upon said intangible property in part.

C. J. JOSEPH.

Sworn and subscribed to before me this 24th day of May, 1922.

[SEAL.]

C. S. MORSE,

Notary Public.

My commission expires: February 19, 1924.

Affidavit of O. S. Thompson.

Filed June 5, 1922.

In the District Court of the United States for the Eastern District
of North Carolina.

In Equity.

SOUTHERN RAILWAY COMPANY et als., Plaintiffs,

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et als.,
Defendants.

Railroad Income Tax Suits.

Affidavit of O. S. Thompson.

O. S. Thompson being duly sworn, deposes and says:

Since 1906 affiant has been connected with the Corporation Commission of North Carolina, and with the State Department of Revenue since its creation in 1921. The Corporation Commission, in addition to its duties as such, was by statute created the State Tax Commission with the duties of administering the tax laws of the State. Affiant's position with the said State Tax Commission was that of Tax Clerk, and as such his duties were the general supervision of the details of the administration of the tax laws of the State. While Tax Clerk of the State Tax Commission affiant had extensive experience with the Standard Classification of Accounts of the Interstate Commerce Commission in connection with preparing the reports of the Corporation Commission based in part on the said Standard Classification.

Affiant is now Deputy Commissioner of Revenue of North Carolina and acting Chief Clerk of the State Department of Revenue and his duties as such are similar to those formerly performed by him as Tax Clerk of said State Tax Commission. Prior to 1906 affiant served as an employee of the Southern Railway Company as clerk handling taxation matters.

In his capacity as Deputy Commissioner of Revenue and acting Chief Clerk of the State Department of Revenue the affiant is familiar with the requirements of that Department as to returns for taxation by taxpayers, with the forms of such returns, and is custodian of the records of the State Department of Revenue. Affiant is familiar with the administration of the tax laws of the State by the State Department.

The State Department of Revenue has only one blank for returns for income tax which is sent out to and used by all railroad corporations engaged in the operation of railroads. This is known as Form 7, and is attached to this affidavit, marked Exhibit A.

This form is required by the State Department of Revenue to be filled out by all railroads doing business in the State of North Carolina, whether operating partly within or partly without the State, whether operating wholly within the State but as common carriers with interstate railroads, or whether doing wholly intrastate business. This Form 7 requires a report by all such railroad corporations of their net income as defined by the Income Tax Act of 1921, under the provisions of section 202 of that Act, and based upon and according to the Standard Classification of Accounts of the Interstate Commerce Commission.

The State Department of Revenue requires all such railroad corporations to make return for income taxation upon this form and ascertain the net income of such railroads for taxation without discrimination according to the provisions of the said section 202.

Affiant has read the affidavits of Nathan O'Berry, President of the Enterprise-Whiteville Lumber Company, and of Mr. A. B. Turnbull, President of the Rowland Lumber Company, filed in their suits by the Norfolk and Southern Railway Company. It is true that these lumber companies and other similar companies are not classed as railroads by the State Department of Revenue, are not treated as railroads for income tax purposes or for any other purposes whatsoever, and are not required to make returns for income tax according to the Standard Classification of Accounts and upon Form 7, but are required to and do make return for income tax on Form 3, which is the Form required by the Department for corporations

in general other than the railroads and other public service corporations taxed according to section 202. In fact, these lumber companies and other similar companies are not railroads and are not public-service corporations. As is stated in the said affidavit by the presidents, their principal business is the lumber business, only such transportation as they carry on is principally the transportation of their own property as incidental to the lumber business. Under section 3413, Consolidated Statutes, the Corporation Commission has the power to grant to such companies authority to transport certain commodities other than their own property, subject to the supervision of the Commission. But the affiant is informed and believes that the purpose of such provision is simply to allow such companies to accommodate immediate communities in which they operate; that when such authority is granted to and exercised by such companies they do not engage in the business of transportation as common carriers for others for profit, but only as the purely incidental service of accommodation; that in any such case the transportation of property of others by such a corporation is wholly negligible in amount and purely incidental to the principal business of the corporation, which is the lumber business.

Affiant states, therefore, as a matter of his own knowledge, that the Income Tax Act of 1921, as administered by the State Department of Revenue, applies exactly in the same way and without any discrimination whatsoever to all railroad corporations doing any business in the State engaged in railroad operation, whether foreign

or domestic, whether operating partly within and partly without the State, or wholly within the State. All are required to make return for income tax according to the Standard Classification of Accounts and under section 202, and exactly the same deductions are allowed to all, without discrimination.

Not only is the entire class of railroads subjected to income taxation under the provisions of section 202 with ascertainment of net income upon the basis of the Standard Classification of Accounts

but the same is true as to the broader class of all strictly public-service corporations and which the affiant is informed and believes are not public-service corporations at all.

The State Department of Revenue has one form for income tax return for all public service corporations other than railroads, Form 8, a copy of which is attached hereto and marked Exhibit B, and which form is substantially identical with Form 7 upon which railroads are required to make return. The Department of Revenue requires, therefore, not only of railroads, but of all other public service corporations, that they file returns for income tax upon the basis of the Standard Classification of Accounts, under the provisions of section 202.

Affiant has read the affidavit of Mr. J. H. Bridges, President of the Henderson Water Company, in which Mr. Bridges states that the Henderson Water Company is not required to and does not keep its records according to the Standard Classification of Accounting and that it did not make return for income taxation according to the said classification under the provisions of section 202. Affiant states that the returns for income taxation in the office of the Department of Revenue for the year ending December 31, 1921, have not yet been audited and checked for correctness. If what Mr. Bridges says with reference to the return made by the Company is true, his company will be required to amend its return and to file a return on Form 8 according to the said Standard Classification and under the provisions of section 202. As the Department of Revenue interprets the Income Tax Act, the Henderson Water Company, as well as all other public service corporations, are required by it to make return for income tax in accordance with the accounting system of the Standard Classification. The auditing of income tax returns for the said year is in progress at this time, but has not been completed, and, with reference to railroads and other public-service corporations, has been held over pending decision in these suits as to the validity of the income tax as to such corporations, in view of the plaintiff's attack upon the income tax law as applied to them.

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O. S. THOMPSON,

Affiant.

Subscribed and sworn before me this the 5 day of June, 1922.

[SEAL.]

W. H. PITTMAN,

Notary Public.

My commission expires July 29, 1922.

73 *Affidavit of A. J. Maxwell.*

Filed June 5, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

SOUTHERN RAILWAY Co., et al., Plaintiffs,

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et als.,
Defendants.

Railroad Income Tax Suits.

Affidavit of A. J. Maxwell.

A. J. Maxwell, being first duly sworn, deposes and says:

Affiant is a member of the State Corporation Commission of North Carolina and has been such since 1910, during which time the said commission was, until 1921, also the State Tax Commission with the duties and functions with reference to administering the tax laws of the State imposed upon the newly created State Department of Revenue by the statute of 1921. In such position the affiant has been directly connected in an official capacity with the administration of the tax laws of the State until the creation of the State Department of Revenue to replace the State Tax Commission as such. In such capacity the affiant was in constant consultation with the finance committees of the General Assembly at the time of the drafting of the Income Tax Act of 1921. In such capacity the affiant has had extensive experience familiarizing him with the Standard Classification of Accounts of the Interstate Commerce Commission, has made a special and comparative study of the taxation system of other states and of the subject of taxation.

When the enactment of the Income Tax Act of 1921 was under consideration in the finance committees of the General Assembly, the railroads were heard on the matter and they made the same objection to the provisions of Section 202 that they are now making in these suits. They argued that the application of those provisions to them would not lead to an ascertainment of their net income because certain items, notably interest on bonded indebtedness and rentals paid for leased properties, were not included in the operating expenses in the said Standard Classification, whereas as to individuals and to corporations other than public-service corporations deductions were allowed under general terms of the Act which the railroads alleged to be analogous to such interest and rentals.

The legislative committees considered these objections fully and

carefully. In enacting the Act in the terms, finally adopted, the General Assembly considered certain well known facts with reference to the method in which railroad corporations are financed. It is a general rule that railroads are financed almost entirely by bond issues, their stock being issued largely incidentally and sometimes even distributed as bonus with the bonds. The rule is that the capital finances are procured by bond issues. This being the case, interest paid on the bonds is properly considered not as a current, operating, or business expense, but as a capital expense. The legislature considered that "net income" as generally understood and as judicially defined means the business revenues less all those expenses incurred in the earning of such revenue, but not deducting any expense on account of or to provide for capital or permanent investment in the business. It was manifest, therefore, that if interest on bonds should be allowed as a deduction in arriving at net income of railroads, this would be the allowing of a capital expense not an operating or business expense, and the result obtained after making such deductions in addition to operating and business expenses would not be the net income of the railroad but less.

With reference to the matters of rentals paid for the lines leased and operated by the railroads, the committees considered the well known facts that these leases are usually for long terms and with numerous collateral obligations which make them amount practically to purchases of the lessor road's properties by the lessee, and that, this being true, the consideration paid for such long leases of property used fully as if the property of the lessee in its business is really not an operating expense but is by clear analogy and in practical effect a capital expense. If these expenses were allowed as deductions to the plaintiffs, the result would be that they would have no income subject to tax until they had earned enough to provide, not only for all business and operating expenses, but also for all capital expenses and had paid all interest on their bonds; in other words, it would amount to nothing more than a tax on the savings of railroads, which would render the tax utterly incommensurate with that imposed as income tax on individuals and other ordinary corporations.

Affiant states it as his opinion that the Income Tax Act as applied to railroads and other public service corporations under the provisions of Sec. 202 results in a strictly fair and just tax upon their net income, entirely commensurate in scope and burden with the tax imposed on other corporations, and individuals, except that perhaps, in view of the fact that individuals are allowed no deduction whatever for living and family expenses, which expenses are analogous to many items allowed all corporations as deductions, the tax bears relatively more heavily on individuals than on corporations by reason of the constitutional inhibition against allowing such deductions to individuals.

As to the contention of the plaintiffs that it is arbitrary classification and discrimination to base a classification on the question whether the taxpayer is required to keep his accounts in accordance with the Standard Classification, the affiant is advised and believes,

and so states, that so long as all railroads are placed within the class and are treated alike without discrimination, the classification is reasonable and not arbitrary, because the distinction of being railroads and not other corporations is a practical and reasonable basis of distinction and classification. Affiant asserts further that all railroads are taxed alike under the Income Tax Act of 1921. All are required to make return for taxation on Income Tax Blank Form 7, according to the Standard Classification of Accounts; and that the class is even broader than that of railroads, including all other public service corporations, these being required to make return on Form 8, according to the same Standard Classification, as sworn to in the affidavit of O. S. Thompson filed by the defendants herein.

When railroads keep the Standard Classification of Accounts, under Federal or State Requirements, the only practical method of requiring return for income tax to be made is according to such classification of accounts, and for the State to require different accounting, or to require return according to another system of accounting, would conflict practically with the system of accounting, would conflict practically with the power of the Interstate Commerce Commission to prescribe uniform classification of accounts. The State of North Carolina has not undertaken to prescribe any system of accounting for the plaintiffs or other railroads in conflict with that already required to be kept by the Interstate Commerce Commission, but has adopted that system as the best and most practical basis for the calculation of net incomes for taxation.

A. J. MAXWELL,

Affiant.

Subscribed and sworn to before me this the 5 day of June, 1922.

[SEAL.]

W. H. PITTMAN,

Notary Public.

My commission expires July 29, 1922.

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Affidavit of R. O. Self.

Filed June 5, 1922.

In the District Court of the United States for the Eastern District
of North Carolina.

In Equity.

SOUTHERN RAILWAY COMPANY et als., Plaintiffs,

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, et als.,
Defendants.

Railroad Income Tax Suits.

Affidavit of R. O. Self.

R. O. Self being duly sworn, deposes and says:

Affiant is the clerk of the State Corporation Commission of North Carolina, has been such since the first of September 1919, and as such is custodian of the records of the said Commission and is thoroughly familiar with the administering by the Commission of its duties and powers given it by statute. He is thoroughly familiar with the classification made by the Corporation Commission of corporations subject to its supervision.

Affiant has read the affidavit of Mr. A. R. Turnbull, President of the Rowland Lumber Company, which affidavit is filed by the Norfolk Southern Railroad Company in these suits, and affiant is familiar with contents thereof. He has also read and is familiar with the contents of the affidavit of Mr. Nathan O'Berry, President of the Enterprise-Whiteville Lumber Company, filed by the said plaintiff in these suits.

The said Rowland Lumber Company, and the said Enterprise-Whiteville Lumber Company do what is known as a limited transportation business, and are authorized by the Commission to carry on their logging roads certain limited commodities other than their own. These corporations are not railroad Corporations, but are lumbering corporations. Their lines of tramway, or railroad, are constructed by them for the purpose of hauling logs and lumber and operating their lumber business. When such roads are established there are frequent demands by the communities through which they run, for them to transport other commodities for the convenience and accommodation of the inhabitants of those communities.

78 Under Section 3413, Consolidated Statutes, the Corporation Commission has the power to, and in proper cases does, grant authority to such logging or lumber companies to carry for hire over their logging, or tramway, roads commodities of others within certain limitations.

These corporations are not classed, considered, or treated by the Corporation Commission as railroads, but they are subjected to the supervision of the Commission, chiefly to prevent discrimination as to the very limited carrier service which they are allowed to perform. They are not classed as common carriers, in the same class as railroads such as the plaintiffs in these suits.

As to the Rowland Lumber Company, it entered into the business referred to in the affidavit of Mr. Turnbull not for profit, but purely for the accommodation of the community, as the following quotations from letters and documents will show:

Letter from Mr. A. R. Turnbull, President, Rowland Lumber Company to W. G. Womble, Rate Clerk, State Corporation Commission, Raleigh, N. C., March 22, 1918:

"It is true that we have been handling fertilizer over the west end of our road for the benefit of the people located in that territory. This is merely an accommodation to them, and is of no benefit to us. * * * If these people do not care for this accommodation it will certainly be a great pleasure for us, under present circumstances to discontinue this hauling of freight for them, as it is done absolutely at cost to us on the present basis."

Letter from Stevens & Beasley, Attorneys for the Rowland Lumber Company, to the North Carolina Corporation Commission, dated March 27, 1918. This letter after referring to complaints made by certain citizens of Faison, N. C., against the Rowland Lumber Company for alleged excessive charges for hauling fertilizer, says:

"The Rowland Lumber Company is not operating a logging business, over its road, this year, in Sampson County to any extent but is confining its operations to its log road in Duplin. It has not even determined to open up its road in Sampson County for the carrying of freight as charged, but was simply coming to the rescue of the farmers of Sampson County, and aiding them, as all good citizens should do, in making food for fighting Germany. For all the winter the roads in that section have been almost impassible with an empty vehicle and had the farmers, many of them 15 miles from the railroad, been permitted by the roads to have hauled at all the cost would have been enormous, from \$3 to \$5 per ton and in this emergency the Rowland Lumber Company has been helping them out at great inconvenience to itself and even a loss. Labor conditions are such the cost of operating is so high that no one except a man like Mr. Turnbull would have undertaken to deliver the fertilizer to these people and he regrets that they have been so shortsighted as to kick, for it might have been possible for the road to have been developed into a public carrier under his generous impulses and public spirit. In building the Atlantic & Carolina Railroad, he has done more for Duplin County than any other one man."

The authority granted to the Rowland Lumber Company, as aforesaid, was granted pursuant to petition filed by the Rowland Lumber Company with the Corporation Commission, copy of which is attached hereto and marked Exhibit "A," and which petition shows that it was made purely to accommodate citizens, who requested such service of the Rowland Lumber Company.

On the 27th of February, 1922, Mr. A. R. Turnbull, President of the Rowland Lumber Company, addressed another letter to Mr. W. G. Womble, Rate Clerk, Corporation Commission, in which he said:

"As you will understand we are not operating on piece of road west of Bowden, but are simply handling fertilizer, etc., for the accommodation of people in that territory. We would be money ahead by discontinuing this service, and will do so if you deem it necessary, but in the meantime, we will do the best we can to give them all the service possible. We have left one locomotive at Bowden to attend to this business and hope to give them better service this year than we have in the past. On the two points, Newton Grove and Eureka Church, however, there will be some delay, and we have notified all shippers whom we know that we do not care to handle this business except in that way."

There is attached hereto and marked Exhibit "B," a schedule of the rates of the Enterprise-Whiteville Lumber Company over its logging road, effective December 1, 1920, as filed with the Corporation Commission, which schedule shows the limitation as to the commodities carried and allowed to be carried by this road.

These logging roads and others similar to them are not classed as railroads and as full common carriers by the Corporation Commission for the reasons above shown, for the reason that their business of carriage of property of others is purely incidental to their business of logging and manufacturing lumber, and is negligible in amount, and for the reason that they maintain no regular schedule of trains, but run simply when there is particular demand

80 for a particular carriage.

R. O. SELF,

Affiant.

Subscribed and sworn to before me this 5 day of June, 1922.

[SEAL.]

W. H. PITTMAN,

Notary Public.

My commission expires July 29, 1922.

EXHIBIT "A"

Rowland Lumber Company.

Norfolk, Va., May 21, 1918.

To the Corporation Commission of North Carolina:

The Rowland Lumber Company respectfully sheweth to the Corporation Commission of North Carolina:

1. That it is a corporation incorporated under the laws of the state of North Carolina, authorized to engage in the Lumber business. In the operation of its timber it has purchased, and caused to — constructed, for logging purposes, a line of railroad running from Bowdens and Warsaw, on the Atlantic Coast Line Railroad, in Duplin County, North Carolina, in a westerly direction for about twenty miles toward Newton Grove.

2. Your petitioner has been, and is continually being, requested by the citizens living along the line of this road to transport freight for them and others; your petitioner is willing to accommodate such parties under present conditions, provided it can do so lawfully.

3. Under Revisal of 1905, Sec. 2598, as amended by Chapter 160, Laws of 1911, your Honorable Body is empowered to authorize this company to transport commodities, and to charge therefor reasonable rates, in addition to the transportation of its own commodities:

Wherefore, your petitioner respectfully prays, that your Honorable Body authorize your petitioner to transport over its logging road, as freight, commodities in carload lots, but excluding lumber and logs, purchased and used along the line of said road, and to make charges therefor; and that this authority be continued from year to year until your petitioner shall give to this Honorable Body necessary notice of its intention to discontinue said service.

Respectfully submitted,

ROWLAND LUMBER COMPANY,

(S.)

By A. R. TURNBULL,

President and General Mgr.

EXHIBIT "B."
Rate of Enterprise Lumber Company Railroad.

Effective December 1, 1920.

Fruit and vegetables, per crate.....	20	20	20	25	25	25
Fruits and vegetables, per car.....	1500	1650	1750	2000	2250	2500
Empty Crates or Barrels, ".....	1500	1650	1750	2000	2250	2500
Ditto each.....	10	10	10½	12½	15	15
Fertilizers, 20 Tons Maximum.....	2500	2600	3000	3250	3500	4000
Fertilizer from 10 to 20 tons, per ton minimum 1,500 per car.....	150	175	200	200	225	275
L. C. L. per ton.....	300	300	325	350	400	450
Cotton Seed and Hulls.....	2000	2200	2400	2700	3000	3300
L. C. L. per ton.....	200	250	300	325	375	400
Holly, Lime and Flour in carload.....	2000	2200	2400	2600	2800	3000
Wood—Minimum 10 cords, per c.....	100	100	100	110	125	150
Cotton, per bale.....	150	150	150	150	175	175
Furniture, per 100 pounds.....	25	27	30	30	30	35
Chickens and eggs.....	30	20	30	30	30	30
Mdse. not classed, per 100.....	20	20	20	25	25	30
Brick, minimum 10 per m.....	300	300	300	300	300	350

All freight is to be loaded and unloaded at expense and risk of shipper. We will not accept any freight either carload or L. C. L. from or to any point except the following:

Oliver's Siding.....	3
Taylor's Siding.....	3½
Loftin's Siding.....	3¾
King's Crossing.....	5½
Dobson's Crossing.....	7¼
Hill's or Cherry's Siding.....	9½
Scott's Store.....	12
Brown's Camp or Snow Hill.....	13
Woodland Siding C. L. only.....	16
Kornegay's Bridge " ".....	17

All cars have to — unloaded on the same day they are placed, or demurrage will be charged. No freight will be shipped collect. Package freight will be carried out only on Fridays and if placed at warehouse on any day previous to Thursday it will be held by this Company at the shipper's risk. Carload shipments will be taken out any day in the week.

ENTERPRISE LUMBER COMPANY.
THOMAS O'BERRY,

General Mgr.

Affidavit of F. C. Harding.

Filed June 20, 1922.

F. C. Harding, being duly sworn, deposes and says, that he is the President of the Greenville and Shelberdine Railroad Company; that the same was chartered in 1920; that the road is 12 miles long, extending from Greenville to Shelberdine and is of narrow gauge. That W. L. Hall is the Secretary of said Railroad Company and that David Hoots is General Superintendent, Engineer and Conductor. That this road has no office, either in Greenville or at Shelberdine or along the route of its railroad. That this road makes, as a general thing, one trip a day.

During the movement of fertilizer in the spring, it often makes two trips a day. That it carries freight for hire, from Greenville to any point along the road to Shelberdine and from Shelberdine to any point along the road to Greenville. That it issues no bills of lading. That the freight it carries from Greenville to Shelberdine, or along the route, is removed from the Atlantic Coast Line Railroad Company cars and placed in this company's car and is delivered along the route to its several patrons. That while people along the route use this road as a convenience to travel, this company has never charged any passenger rates. That this company has never made any report to the State Corporation Commission or to the Internal Revenue Commissioner and of course has never made any interstate

report as it does not do any interstate business as all of its business is intrastate. That this road is not a lumber road. It was originally built for a lumber road but when the Beaufort County Lumber Co. removed from Pitt County, the road was purchased by the present owners who afterwards incorporated under the style above named.

Affiant further states that the Greenville and Shelberdine Railroad Company does not keep its accounts according to the standard classification of accounts promulgated by the Interstate Commerce Commission.

F. C. HARDING.

Subscribed and sworn to before me this 20th day of June 1922.

M. V. HARDING,
Notary Public.

My commission expires Nov. 3, 1922.

84 *Affidavit of J. C. Nelms, Jr. (May 17, 1922).*

Filed June 20, 1922.

J. C. Nelms, Jr., being first duly sworn, deposes and says:

That he is General Auditor of Norfolk Southern Railroad Company; that during the year 1921, Norfolk Southern Railroad Company operated a line of railroad owned by Carthage & Pinchurst Railroad Company, extending from Pinchurst to Carthage, North Carolina, under a lease which had expired, the reason for the continued operation thereof being that it had been prohibited by the laws of the United States to abandon said line of railroad unless permission was granted by the Interstate Commerce Commission;

That during the year 1921, it paid as rent for the use of said property in the business or trade of Norfolk Southern Railroad Company the rent stipulated to be paid in said lease.

That Norfolk Southern Railroad Company had not taken title to and was not taking title to said property, and had no equity therein.

(S.)

J. C. NELMS, JR.

Subscribed and sworn to before me this 17th day of May 1922.

(S.)

GILBERT C. REVEILLE,
Notary Public.

[SEAL.]

My commission expires on the 31st day of August, 1924.

85 *Affidavit of J. C. Nelms, Jr. (May 18, 1922).*

In the District Court of the United States for the Eastern District of North Carolina.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Affidavit.

J. C. Nelms, Jr., being first duly sworn, deposes and says:

That he is a citizen and resident of the County of Norfolk, and State of Virginia; that he is General Auditor of Norfolk Southern Railroad Company and has occupied that position since April, 1915; that he is familiar with the rules of accounting for steam and electric railroads as prescribed by the Interstate Commerce Commission.

On the 19th of May, 1914, effective July 1, 1914, the Interstate Commerce Commission issued orders classifying the accounts of steam railroads, and dividing the accounts into two classes:

- (1) Operating Revenues and Operating Expenses; and,
- (2) Income, Profit and Loss, and General Balance Sheet Accounts.

These rules are still in force, subject to such modifications and explanations as have been made by the Commission since that date.

That the order prescribing the classification of Operating Revenues and Operating Expenses of Steam Roads, among other things provided:

"It is ordered, That, the Classification of Operating Revenues and Operating Expenses of Steam Roads and the text pertaining thereto, embodied in printed form to be hereafter known as Issue of 1914, a copy of which is now before this Commission, be, and is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Division of Carriers' Accounts; and that each of said copies so authenticated and filed shall be deemed an original record thereof.

"It is further ordered, That the said Classification of Operating Revenues and Operating Expenses of Steam Roads, with the text pertaining thereto, be, and is hereby, prescribed for the use of carriers by rail (exclusive of electric railways) subject to the provisions of the Act to Regulate Commerce as amended, in the keeping and recording of their operating revenue and operating expense accounts; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to

keep all operating revenue and operating expense accounts in conformity therewith; and that a copy of said issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier."

This affiant has a copy of the said order and the classification of accounts and instructions accompanying the same.

Accompanying said order, as sent to the carriers, was an introductory letter, which among other things stated that:

"Accounts are provided in this classification for the revenues and expenses of operations which heretofore have been classed as auxiliary or outside operations. The purpose in merging these accounts has been to secure a statement of revenues and expenses in connection with the operation of all physical property the cost of which is includible in the accounts for investment in road and equipment. The accounts for maintenance of physical property have been arranged to correspond with those for the investment in such property. Depreciation accounts have been provided for the current depreciation of fixed improvements, although until further directed the recognition in operation expenses of current depreciation of fixed improvements is optional with the carrier. It is provided that organization and general administration expenses directly assignable to investments in stocks, bonds, and other securities shall be excluded from the accounts of this classification and included in income account No. 549, "Maintenance of investment organization."

There also accompanied said order and classification certain general instructions, among which were the following:

"1. Operating Accounts.—The accounts of this classification are designed to show the revenues and expenses (including the maintenance of the facilities used) of the carrier's railway operations, including rail-line transportation, water-line transportation, if any, and services incident to transportation. Transportation includes the receipt, conveyance, and delivery of traffic."

"4. Miscellaneous Operations.—The revenue and expenses of miscellaneous operations involving the use of such facilities as hotels and restaurants, power plants, cold-storage plants, *coal-storage plants*, cotton compress plants, wood-preserving plants, ice-supply plants, etc., shall not be included in the accounts of this classification when the facilities used are distinct from those used by the carrier in the service of transportation or in the maintenance of facilities used in transportation service, and the operations are not incident to such service. (See income accounts No. 502, "Revenue from miscellaneous operations," and No. 534, "Expenses of miscellaneous operations," and balance-sheet account No. 705, "Miscellaneous physical property.")"

There also accompanied said order certain special instructions, among which was:

"1. Accounts for Operating Revenues.—The accounts provided for operating revenues are designed to show amounts of money which a carrier becomes entitled to receive from transportation and from operations incident thereto."

The Operating Revenue accounts were by the said classification divided into general accounts and primary accounts. A statement of the general accounts and primary accounts for steam railroads, according to the said classification, showing the number of each account, as set out in said rule and order is hereto attached marked Exhibit A and prayed to be taken as a part of this affidavit.

The said order prescribed that account 142 "Rents of Buildings and other property," should include: "the revenue from the exclusive use of buildings and other property or portions thereof, such as depot and station grounds and buildings, general and other offices, wharves, ferry landings, elevators, stockyards, fuel yards, enginehouses, repair shops, and section and other houses, when the property is operated and maintained in connection with the property used in the carrier's transportation operations and the expenses of maintaining and operating the rented portion cannot be separated from the expenses of that portion used by the carrier."

As to the General Account No. IV, Joint Facility, being primary accounts Nos. 151 and 152, the said order provides that these accounts should include the carrier's proportion of revenue collected by others in connection with the operation of joint tracks, yards, terminals and other facilities, and also that proportion of revenue from the operation of joint tracks, yards terminals and other facilities, which is creditable to other companies.

The account did not include the rent paid for the use of the joint facilities, simply results of operations.

The operating expenses were by said order divided into eight general accounts, and into quite a number of primary accounts. A statement is hereto attached showing the general and primary accounts of steam railroads. Said statement is marked Exhibit B and is prayed to be taken as a part hereof.

The special instructions accompanying said order, among other things, stated that: "The accounts prescribed for operating expenses are designed to show expenses of furnishing transportation service, including the expenses of maintaining the plant used in the service."

The accounts of Norfolk Southern Railroad Company are and have been kept in accordance with the rules and regulations prescribed by the Interstate Commerce Commission as set out in said orders, as explained by the instructions and orders of the Commission, modifying or explaining the aforesaid order of May 19, 1914.

The said accounts and reports made to the Commission in accordance with said rules and regulations do not contain any such term as "Net Operating Income." The reports of Norfolk Southern Railroad Company made to the Interstate Commerce Commission show

the total amount of its operating revenues and also shows the total amount of its operating expenses, and also the difference between these two amounts, which in said reports, and under the rules prescribed by the Interstate Commerce Commission, is denominated and known as "Net Revenue from Railway Operations." The Net Revenue from Railway Operations of Norfolk Southern Railroad Company and of corporations operating steam or electric railroads, keeping their accounts in accordance with the standard classification of accounting of the Interstate Commerce Commission, is the difference between the amount of money which Norfolk Southern Railroad Company or such other similar corporations, receives from transportation, as the term "Transportation" is defined in the said classification of accounts and in the Interstate Commerce Act, and the amount paid out for "all the ordinary and necessary expenses paid during the income year for conducting and carrying on transportation, as transportation is defined in the said classification of accounts and in the Interstate Commerce Act, including as a part of said expenses depreciation on its equipment, to-wit: steam locomotives, other locomotives, freight train cars, passenger train cars, motor equipment of cars, floating equipment, work equipment and miscellaneous equipment, if any."

Accounts of operating revenues and operating expenses of steam railroads, such as Norfolk Southern Railroad Company, and other similar corporations, kept in accordance with standard classification of accounting of the Interstate Commerce Commission do not include all gain derived from capital or labor or both combined, provided it is understood that the term "gain" includes profit gained through a sale or conversion of capital assets.

The said operating revenues and operating expenses of steam roads does not include the following items of gain or income which such corporations may receive during any period of time, but said items or sources of revenue or gain are in accordance with said classification carried under what is known as income accounts, to-wit: revenues from miscellaneous operations, hire of freight cars, credit balance, rents from locomotives, rents from passenger train cars, rents

from floating equipment, rents from work equipment, joint
 89 facility rent income, income from lease of road, miscellaneous
 rent income, miscellaneous non-operating physical property,
 separately operated properties,—profit, dividend income, income from
 funded securities, income from unfunded securities and accounts, income from sinking and other reserve funds, release of premiums on
 funded debt, contributions from other companies, and miscellaneous
 income, all of which are gain from labor or capital or both combined
 or from a sale or conversion of capital assets.

The accounts of operating revenues and operating expenses of steam railroads, when such accounts are kept in accordance with the standard classification of accounting of Interstate Commerce Commission, do not include all of the expenses of conducting and carrying on the business of the corporation, and do not include many items of

expenses which are necessary to be paid in order that the business may be carried on, to-wit: railway tax accruals; uncollectible railway revenues; expenses of miscellaneous operations; taxes on miscellaneous operating property; hire of freight cars—debit balance; rent for locomotives; rent for passenger-train cars; rent for floating equipment; rent for work equipment; joint facility rents; rent for leased roads; miscellaneous rents; miscellaneous tax accruals; separately operated properties—loss; interest on funded debt; interest on unfunded debt; amortization of discount on funded debt; maintenance of investment organization; income transferred to other companies; miscellaneous income charges; income applied to sinking and other reserve funds; dividend appropriations of income; income appropriated for investment in physical property; stock discount extinguished through income; and miscellaneous appropriations of income.

Under the aforesaid orders of the Interstate Commerce Commission dividing the accounts of corporations, operating steam railroads engaged in interstate commerce, into the two general classes as aforesaid, to-wit: Operating Revenues and Operating Expenses on the one part, and Income, Profit and Loss, and General Balance Sheet Accounts on the other, the Interstate Commerce Commission prescribed with great care and particularity the items of revenue which should go into each of the income accounts both credit and debit accounts.

A list of the primary accounts constituting the income accounts under said classification, both credit and debit is hereto attached, marked Exhibit C and prayed to be taken as a part hereof.

In addition, the said order of the Commission in prescribing rules of accounting for corporations operating steam railroads engaged in interstate commerce, prescribed a form of income statement. A copy of said form is hereto attached and made a part hereof, marked Exhibit D, and prayed to be taken as a part hereof.

90 The accounts of Norfolk Southern Railroad Company are kept in accordance with the aforesaid classification, its income statement is made to accord with the form of income statement prescribed in said rules of accounting and it reports to the Interstate Commerce Commission its operating revenues, operating expenses, other items of intake and outgo, all as prescribed by the Interstate Commerce Commission.

The term "Operation Ratio" does not appear in said rules of accounting. The term "operating ratio" is generally understood to mean and be that percent which the operating expenses as prescribed by the Interstate Commerce bears to the operating revenues as prescribed by the Interstate Commerce Commission.

The difference between the operating revenue and operating expenses of a corporation operating the steam railroads in keeping its accounts in accordance with the rules of the Interstate Commerce Commission does not show or purport to show the net income of such corporations, but purports to show and shows the difference between the amount of revenue received from the business of conducting and carrying on its transportation and the operations incident thereto and the cost and expense of conducting such transportation and the incidents thereto.

In order to obtain the net income of such corporations it is necessary to consider and take into consideration the income accounts of said corporation as prescribed and shown in the rules of accounting of the Interstate Commerce Commission, and is set out in the form of income statement prescribed by the Commission, and which such railroad companies are required to make to the Commission.

Norfolk Southern Railroad Company owns and operates a line of electric railroad which runs from Norfolk to Virginia Beach and thence to Cape Henry, thence returning to Norfolk. In making reports to the Interstate Commerce Commission under the orders of the Commission the accounts of the electric division and the steam division are combined. Under permission granted by the Interstate Commerce Commission, Norfolk Southern Railroad Company keeps records showing the accounts of the electric division or electric railroad separate from the steam division or steam railroad. No part of the electric railroad is situated in North Carolina. The steam railroad extends and is situated both in North Carolina and Virginia. The ratio of operating expenses to operating revenue of the electric division was for the year 1921, 74.37% and for the steam division 84.51%, and for the entire system including both steam and electric divisions, 83.81%. That is to say that out of every dollar received by Norfolk Southern Railroad Company in payment for services rendered in the conduct of transportation on its electric division, as transportation is defined in classification of accounts of the Interstate Commerce Commission, it paid out in operating expenses, as

91 such operating expenses are defined in said classification of accounts, 74.37 cents. That or its steam division, which is located partly in North Carolina and partly in Virginia, where the business is both local and through, in both states, out of every dollar taken in for services rendered in the conduct of transportation, both intra and interstate, it became necessary to pay, and the company did pay in operating expenses as operating expenses are defined in said classification, the sum of 84.51 cents. That considering its entire system, both electric and steam, out of every dollar taken in payment for services rendered in transportation, both interstate and intrastate, as transportation is defined in the standard classification of accounting of the Interstate Commerce Commission, it becomes necessary for Norfolk Southern Railroad Company to pay for operating expenses in conducting transportation, as transportation is defined in the classification of accounting of the Interstate Commerce Commission 83.81 cents.

That in addition to the operating expenses aforesaid it became necessary for Norfolk Southern Railroad Company, in order to conduct and carry on its business and especially its business on steam division, to pay sums and items as set out in section 23 of the bill of complaint filed in this case.

During the calendar year 1921, which was the income year 1921, Norfolk Southern Railroad Company paid expenses for conducting and carrying on its business which are not included under the head of operating expenses under the rules of accounting of the Interstate Commerce Commission, as follows, to-wit:

Joint Facility Rents, that is rents for tracks, yards, terminals and other facilities owned or controlled by other carriers, companies or individuals, and in the joint use of which Norfolk Southern Railroad Company participated, in the sum of \$37,366.96 of which \$34,009.76 was allocatable to that part of the road located in North Carolina.

For rent of roads, tracks or bridges, including equipment and other railway property covered by the contract of lease of other companies held under lease or other agreement, by the terms of which the exclusive use and control for operating purposes are secured, the sum of \$160,365.96, the entire amount of which was for properties located in North Carolina.

For the use of miscellaneous property, that is property which was not used in the operation of the railroad, but used in the conduct of its business and necessary so to be used, the sum of \$1,376.63 of which \$372.83 was allocatable to North Carolina.

For interest on its funded debt the sum of \$884,399.57 of which \$778,351.22 was and is allocatable to the State of North Carolina.

For interest on unfunded debt \$37,025.96, of which \$32,587.06 is allocatable to North Carolina.

For amortization of discount on funded debt, being a proportion of the discount and expense on funded debt of the company applicable to that period, in accordance with the standard rules of accounting of the Interstate Commerce Commission \$24,719.53 of which \$21,755.41 was and is allocatable to North Carolina.

Other expenses of conducting and carrying on its business which, in the standard classification of accounting of the Interstate Commerce Commission is designated as miscellaneous income charges, the sum of \$57,897.34, of which \$50,778.85 is allocatable to the State of North Carolina.

That Norfolk Southern Railroad Company had not taken title, was not taking title, and had no equity in any of the properties leased, including the railroads or joint facilities, and which are referred to as having been secured for its use in the conduct of its business by payment of the rents aforesaid.

That under the orders of the Commission, the form of accounting prescribed for operating expenses carried accounts "for the current depreciation of fixed improvements." The said orders and instructions further provided that the recognition of and charging out in operating expenses current depreciation of fixed improvements is and was optional with the carrier. Norfolk Southern Railroad Company has never charged out in its operating expenses any current depreciation for fixed improvements.

(S)

J. C. NELMS, JR.

Sworn and subscribed to before me this 18 day of May, 1922.

(S)

GILBERT C. REVEILLE.

[SEAL.]

Notary Public.

My commission expires on the 31st day of August, 1924.

EXHIBIT A.

Operating Revenue Accounts.

General Accounts.

- I. Transportation—Rail Line.
- II. Transportation—Water Line.
- III. Incidental.
- IV. Joint Facilities.

Primary Accounts.

I. Transportation—Rail line:

- 101. Freight.
- 102. Passenger.
- 103. Excess baggage.
- 104. Sleeping car.
- 105. Parlor and chair car.
- 106. Mail.
- 107. Express.
- 108. Other passenger-train.
- 109. Milk.
- 110. Switching.
- 111. Special service train.
- 112. Other freight-train.
- 113. Water transfers—Freight.
- 114. Water transfers—Passenger.
- 115. Water transfers—Vehicles and live stock.
- 116. Water transfers—Other.

II. Transportation—Water line—

- 121. Freight.
- 122. Passenger.
- 123. Excess baggage.
- 124. Other passenger service.
- 125. Mail.
- 126. Express.
- 127. Special service.
- 128. Other.

III. Incidental—

- 131. Dining and buffet.
- 132. Hotel and restaurant.
- 133. Station, train, and boat privileges.
- 134. Parcel room.
- 135. Storage—Freight.
- 136. Storage—Baggage.

- 137. Demurrage.
- 138. Telegraph and telephone.
- 139. Grain elevator.
- 140. Stockyard.
- 141. Power.
- 142. Rents of buildings and other property.
- 143. Miscellaneous.

IV. Joint Facility—

- 151. Joint Facility—Cr.
- 152. Joint Facility—Dr.

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EXHIBIT B.

Operating Expense Accounts.

General Accounts.

- I. Maintenance of Way and Structures.
- II. Maintenance of Equipment.
- III. Traffic.
- IV. Transportation—Rail line.
- V. Transportation—Water line.
- VI. Miscellaneous operations.
- VII. General.
- VIII. Transportation for investment—Cr.

Primary Accounts.

I. Maintenance of Way and Structures—

- 201. Superintendence.
- 202. Roadway maintenance.
- 203. Roadway—Depreciation.
- 204. Underground power tubes.
- 205. Underground power tubes—Depreciation.
- 206. Tunnels and subways.
- 207. Tunnels and subways—Depreciation.
- 208. Bridges, trestles, and culverts.
- 209. Bridges, trestles, and culverts—Depreciation.
- 210. Elevated structures.
- 211. Elevated structures—Depreciation.
- 212. Ties.
- 213. Ties—Depreciation.
- 214. Rails.
- 215. Rails—Depreciation.
- 216. Other track material.
- 217. Other track material—Depreciation.
- 218. Ballast.
- 219. Ballast—Depreciation.

220. Track laying and surfacing.
221. Right-of-way fences.
222. Right-of-way fences—Depreciation.
223. Snow and sand fences and snowsheds.
224. Snow and sand fences and snowsheds—Depreciation.
225. Crossings and signs.
226. Crossings and signs—Depreciation.
227. Stations and office buildings.
228. Stations and office buildings—Depreciation.
229. Roadway buildings.
230. Roadway buildings—Depreciation.
231. Water stations.
232. Water stations—Depreciation.
233. Fuel stations.
234. Fuel stations—Depreciation.
235. Shops and enginehouses.
236. Shops and enginehouses—Depreciation.
- 95 237. Grain elevators.
238. Grain elevators—Depreciation.
239. Storage warehouses.
240. Storage warehouses—Depreciation.
241. Wharves and docks.
242. Wharves and docks—Depreciation.
243. Coal and ore wharves.
244. Coal and ore wharves—Depreciation.
245. Gas producing plants.
246. Gas producing plants—Depreciation.
247. Telegraph and telephone lines.
248. Telegraph and telephone lines—Depreciation.
249. Signals and interlockers.
250. Signals and interlockers—Depreciation.
251. Power plant dams, canals, and pipe lines.
252. Power plant dams, canals, and pipe lines—Depreciation.
253. Power plant buildings.
254. Power plant buildings—Depreciation.
255. Power substation buildings.
256. Power substation buildings—Depreciation.
257. Power transmission systems.
258. Power transmission systems—Depreciation.
259. Power distribution systems.
260. Power distribution systems—Depreciation.
261. Power line poles and fixtures.
262. Power line poles and fixtures—Depreciation.
263. Underground conduits.
264. Underground conduits—Depreciation.
265. Miscellaneous structures.
266. Miscellaneous structures—Depreciation.
267. Paving.
268. Paving—Depreciation.
269. Roadway machines.

- 270. Roadway machines—Depreciation.
- 271. Small tools and supplies.
- 272. Removing snow, ice and sand.
- 273. Assessments for public improvements.
- 274. Injuries to persons.
- 275. Insurance.
- 276. Stationery and printing.
- 277. Other expenses.
- 278. Maintaining joint tracks, yards, and other facilities—
Dr.
- 279. Maintaining joint tracks, yards, and other facilities—
Cr.

II. Maintenance of Equipment—

- 301. Superintendence.
- 302. Shop machinery.
- 303. Shop machinery—Depreciation.
- 304. Power plant machinery.
- 305. Power plant machinery—Depreciation.
- 306. Power substation apparatus.
- 307. Power substation apparatus—Depreciation.
- 308. Steam locomotives—Repairs.
- 309. Steam locomotives—Depreciation.
- 310. Steam locomotives—Retirements.
- 311. Other locomotives—Repairs.
- 312. Other locomotives—Depreciation.
- 313. Other locomotives—Retirements.
- 314. Freight-train cars—Repairs.
- 315. Freight-train cars—Depreciation.
- 316. Freight-train cars—Retirements.
- 317. Passenger-train cars—Repairs.
- 318. Passenger-train cars—Depreciation.
- 319. Passenger-train cars—Retirements.
- 320. Motor equipment of cars—Repairs.
- 321. Motor equipment of cars—Depreciation.
- 322. Motor equipment of cars—Retirements.
- 323. Floating equipment—Repairs.
- 324. Floating equipment—Depreciation.
- 325. Floating equipment—Retirements.
- 326. Work equipment—Repairs.
- 327. Work equipment—Depreciation.
- 328. Work equipment—Retirements.
- 329. Miscellaneous equipment—Repairs.
- 330. Miscellaneous equipment—Depreciation.
- 331. Miscellaneous equipment—Retirements.
- 332. Injuries to persons.
- 333. Insurance.
- 334. Stationery and printing.
- 335. Other expenses.
- 336. Maintaining joint equipment at terminals—Dr.
- 337. Maintaining joint equipment at terminals—Cr.

III. Traffic—

- 351. Superintendence.
- 352. Outside agencies.
- 353. Advertising.
- 354. Traffic associations.
- 355. Fast freight lines.
- 356. Industrial and immigration bureaus.
- 357. Insurance.
- 358. Stationery and printing.
- 359. Other expenses.

IV. Transportation—Rail line—

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- 371. Superintendence.
- 372. Dispatching trains.
- 373. Station employees.
- 374. Weighing, inspection, and demurrage bureaus.
- 375. Coal and ore wharves.
- 376. Station supplies and expenses.
- 377. Yardmasters and yard clerks.
- 378. Yard conductors and brakemen.
- 379. Yard switch and signal tenders.
- 380. Yard enginemen.
- 381. Yard motormen.
- 382. Fuel and yard locomotives.
- 383. Yard switching power produced.
- 384. Yard switching power purchased.
- 385. Water for yard locomotives.
- 386. Lubricants for yard locomotives.
- 387. Other supplies for yard locomotives.
- 388. Enginehouse expenses—Yard.
- 389. Yard supplies and expenses.
- 390. Operating joint yards and terminals—Dr.
- 391. Operating joint yards and terminals—Cr.
- 392. Train enginemen.
- 393. Train motormen.
- 394. Fuel for train locomotives.
- 395. Train power produced.
- 396. Train power produced purchased.
- 397. Water for train locomotives.
- 398. Lubricants for train locomotives.
- 399. Other supplies for train locomotives.
- 400. Enginehouse expenses—Train.
- 401. Trainmen.
- 402. Train supplies and expenses.
- 403. Operating sleeping cars.
- 404. Signal and interlocker operation.
- 405. Crossing protection.
- 406. Drawbridge operation.
- 407. Telegraph and telephone operation.
- 408. Operating floating equipment.

- 409. Express service.
- 410. Stationery and printing.
- 411. Other expenses.
- 412. Operating joint tracks and facilities—Dr.
- 413. Operating joint tracks and facilities—Cr.
- 414. Insurance.
- 415. Clearing wrecks.
- 416. Damage to property.
- 417. Damage to live stock on right of way.
- 418. Loss and damage—Freight.
- 419. Loss and damage—Baggage.
- 420. Injuries to persons.

V. Transportation—Water line—

- 431. Operation of vessels.
- 432. Operation of terminals.
- 433. Incidental.

VI. Miscellaneous operations—

- 441. Dining and buffet service.
- 442. Hotels and restaurants.
- 443. Grain elevators.
- 444. Stockyards.
- 445. Producing power sold.
- 446. Other miscellaneous operations.

VII. General—

- 451. Salaries and expenses of general officers.
- 452. Salaries and expenses of clerks and attendants.
- 453. General office supplies and expenses.
- 454. Law expenses.
- 455. Insurance.
- 456. Relief department expenses.
- 457. Pensions.
- 458. Stationery and printing.
- 459. Valuation expenses.
- 460. Other expenses.
- 461. General joint facilities—Dr.
- 462. General joint facilities—Cr.

VIII. Transportation for investment—Cr.

EXHIBIT C.

Income Accounts.

Primary Accounts.

I. Credits:

- 501. Railway operating revenues.
- 502. Revenues from miscellaneous operations.

- 503. Hire of freight cars—Credit balance.
- 504. Rent from locomotives.
- 505. Rent from passenger-train cars.
- 506. Rent from floating equipment.
- 507. Rent from work equipment.
- 508. Joint facility rent income.
- 509. Income from lease of road.
- 510. Miscellaneous rent income.
- 511. Miscellaneous non-operating physical property.
- 512. Separately operated properties—Profit.
- 513. Dividend income.
- 514. Income from funded securities.
- 515. Income from unfunded securities and accounts.
- 516. Income from sinking and other reserve funds.
- 517. Release of premiums on funded debt.
- 518. Contributions from other companies.
- 519. Miscellaneous income.

II. Debits:

- 531. Railway operating expenses.
- 532. Railway tax accruals.
- 533. Uncollectible railway revenues.
- 534. Expenses of miscellaneous operations.
- 535. Taxes on miscellaneous operating property.
- 536. Hire of freight cars—Debit balance.
- 537. Rent for locomotives.
- 538. Rent for passenger-train cars.
- 539. Rent for floating equipment.
- 540. Rent for work equipment.
- 541. Joint facility rents.
- 542. Rent for leased roads.
- 543. Miscellaneous rents.
- 544. Miscellaneous tax accruals.
- 545. Separately operated properties—Loss.
- 546. Interest on funded debt.
- 547. Interest on unfunded debt.
- 548. Amortization of discount on funded debt.
- 549. Maintenance of investment organization.
- 550. Income transferred to other companies.
- 551. Miscellaneous income charges.
- 552. Income applied to sinking and other reserve funds.
- 553. Dividend appropriations of income.
- 554. Income appropriated for investment in physical property.
- 555. Stock discount extinguished through income.
- 556. Miscellaneous appropriations of income.

EXHIBIT D.

Form of Income Statement.

I. Operating income—

- 501. *Railway operating revenues.
- 531. *Railway operating expenses.
- *Net revenues from railways operations.
- 532. *Railway tax accruals.
- 533. *Uncollectible railway revenues.
- *Railway operating income.
- 502. Revenues of miscellaneous operations.
- 534. Expenses of miscellaneous operations.
- Net revenue from miscellaneous operations.
- 535. Taxes on miscellaneous operating property.
- Miscellaneous operating income.
- Total operating income.

II. Non-operating Income—

- 503. Hire of freight cars—Credit balance.
- 504. Rent from locomotives.
- 505. Rent from passenger-train cars.
- 506. Rent from floating equipment.
- 507. Rent from work equipment.
- 508. Joint facility rent income.
- 509. Income from lease of road.
- 510. Miscellaneous rent income.
- 511. Miscellaneous non-operating physical property.
- 512. Separately operated properties—Profit.
- 513. Dividend income.
- 514. Income from funded securities.
- 515. Income from unfunded securities and accounts.
- 516. Income from sinking and other reserve funds.
- 517. Release of premiums on funded debt.
- 518. Contributions from other companies.
- 519. Miscellaneous income.
- Total non-operating income.
- Gross income (or loss).

III. Deductions from gross income:

- 536. Hire of freight cars—Debit balance.
- 537. Rent for locomotives.
- 538. Rent for passenger-train cars.
- 539. Rent for floating equipment.
- 540. Rent for work equipment.
- 541. Joint facility rents.

*Includes operations of water lines, if any.

- 542. Rent for leased roads.
- 543. Miscellaneous rents.
- 544. Miscellaneous tax accruals.
- 545. Separately operated properties—Loss.
- 546. Interest on funded debt.
- 101 547. Interest on unfunded debt.
- 548. Amortization of discount on funded debt.
- 549. Maintenance of investment organization.
- 550. Income transferred to other companies.
- 551. Miscellaneous income charges.
- Total deductions from gross income.
- Net income (or loss).

IV. Disposition of Net Income:

- 552. Income applied to sinking and other reserve funds.
- 553. Dividend appropriations of income.
- 554. Income appropriated for investment in physical property.
- 555. Stock discount extinguished through income.
- 556. Miscellaneous appropriations of income.
- Total appropriations.
- Income balance transferred to credit (or debit) of Profit and Loss.

102 *Affidavit of J. C. Nelms, Jr. (June 12, 1922).*

Filed June 20, 1922.

J. C. Nelms, Jr., being first duly sworn, deposes and says: that Accompanying and constitution a part of the order of the Interstate Commerce Commission, made the 19th of May, 1914, effective July 1st, 1914, and still in force, with such modifications and amendments as may have been made thereto, were certain special instructions of which No. — reads as follows:

"Income accounts are these designed to show, as nearly as practicable, for each fiscal period, the total amount of money that a carrier becomes entitled to receive for services rendered, the returns accrued upon investments, the accrued costs paid or payable for the services rendered by it, the losses sustained by it, the amounts accrued for taxes, for use of moneys and for use of properties of others, and the appropriations made from income during the period. The net balance of income (or less) shall be carried to Profit and Loss."

The order above referred to is the order of the Commission regulating the keeping of records by Interstate Carriers by Railroad, known as "Classification of Income, Profit and Loss, and General Balance Sheet Accounts for Steam Roads."

J. C. NELMS, Jr.

Sworn and subscribed to before me this 12th day of June, 1922.

GILBERT C. REVEILLE,

Notary Public.

My commission expires the 31st day of August, 1924.

103 *Testimony of R. O. Self at Hearing Before Judge Connor.*

It is agreed that all affidavits filed in the cause by either of the plaintiffs or by the defendants will be treated as in evidence in all cases.

Mr. R. O. Self, Clerk of the North Carolina Corporation Commission produced a list of the corporations operating as limited common carriers in North Carolina under authority granted by the State Corporation Commission under section 3413 of the Consolidated Statutes of North Carolina. Also a memorandum adding two others roads was attached, all filed as Exhibit A.

R. O. SELF, witness for the defendant, examined by Judge Manning, testifies as follows:

That the several roads mentioned in Exhibit A were lumber roads, for logging purposes, operating under Section 3413 of the Consolidated Statutes as a limited carrier, with the right to stop at anytime.

104 *Exhibit "A" to Testimony of R. O. Self.*

STATE OF NORTH CAROLINA:

Office of the Corporation Commission.

This is to certify, that the Corporation Commission of North Carolina, acting under power vested in it by Sec. 3413 of the Consolidated Statutes of North Carolina, has granted authority to the corporations named below to conduct and carry on the business of limited common carriers between the points designated as to each of the corporations named, and that said corporations have filed with the Corporation Commission of North Carolina tariffs establishing the rate of charges which they are authorized to make for the transportation of commodities between the points named.

The corporations named and the points between which they are authorized to act as limited common carriers, engaged in Intra-state Commerce in North Carolina over a line of steam railroad, are as follows:

Andrews Manufacturing Company, Between Andrews and Old Road Gap, a distance of 8 miles, or thereabouts.

Carr Lumber Company, Between Pisgah Forest and Vanderbilt Boundary, a distance of about 20 miles.

Empire Manufacturing Company, Between Oliver Station to within three miles of Bentonville, about 13 miles.

Enterprise Lumber Company, Between Mount Olive and New Camp, a distance of 18 miles, or thereabouts.

Fishing Creek Timber & Railroad Company, Between Stamper, N. C., and Coffield's Bridge, about 10 miles.

Carolina Southern Railroad, Between Hollister and Vaughan, a distance of 14½ miles, or thereabouts.

105 Montgomery Lumber Company, Between Spring Hope and Bunn, N. C., a distance of 10 miles, or thereabouts.

Oeona Lufty Railroad Company, Between Oeona Lufty, N. C. and Smokemont, N. C., about 10 miles.

Rowland Lumber Company, Between Bowdens, N. C., and Warsaw, N. C., toward Newton Grove, a distance of about 20 miles.

Waccamew Lumber Company, Between Bolton and Makatoka, a distance of about 18 miles.

Weldon Lumber Company, Between Weldon, N. C., and a point near Ringwood, a distance of about 20 miles.

Whiteville Lumber Company, Between Whiteville, N. C., and Buttler, a distance of about 27 miles.

Mill Creek Valley Railroad Between — and — a distance of about — miles.

Suncrest Lumber Co., Sunburst to Canton.

Hilton Railroad & Logging Co., Hilton Creek to Island Creek, 6 miles.

Done at the office of the Corporation Commission, at Raleigh, on that the — day of May 1922, by the Corporation Commission, through W. T. Lee, its Chairman, and under the seal of the said Commission.

106 *Testimony of C. J. Joseph at Hearing Before Judge Connor*

C. J. JOSEPH, Tax Agent of the A. C. L. Railroad, witness for the Plaintiff, examined by Mr. Thomas W. Davis, testifies as follows:

That he had for a great many years been the tax agent of that road, with the duty of checking and looking after all the taxes of that Company and its affiliated lines in Virginia, North and South Carolina, Georgia, Florida and Alabama. That he was familiar with this litigation and with the Income Tax Laws of North Carolina; that he has to keep up with the stocks and bonds and statistics of the various roads mentioned; that he is familiar with the commercial and Financial Chronicle, a financial trade paper, circulated throughout the United States, that collects statistics as to capitalization and earnings of the various railroads and industrial corporations and their stocks and bonds. The issue of May 27, 1922 of that paper was offered in evidence, and Mr. Davis desired to read into the record the capital stock and bonds of certain industrial corporations reporting to the North Carolina Tax Commission, the Tax Commission showing the capital, but not the bonds issued by them.

107 *EXHIBIT TO TESTIMONY OF C. J. JOSEPH.*

Representative Partial List of Industrial Corporations Doing Business in North Carolina and Reporting to the North Carolina Corporation Commission and Commissioner of Revenue Financed by Bonds and Stocks.

American Agricultural Chemical Company:

Common stock	\$33,322,125
Preferred Stock	28,455,200
First Mortgage bonds	6,252,000
1st Ref. Mortgage s. f. gold bonds, Series "A", ..	30,000,000

American Sugar Refining Company:

Common Stock	45,000,000
Preferred Stock	45,000,000
15 Year Gold Bonds	30,000,000

American Tobacco Company:

Common Stock "A"	40,242,400
Common Stock "B"	49,344,200
Preferred Stock	52,699,700
Gold Bonds	371,950
Gold Bonds & Cons. Tobacco Collateral Trust Trust Mortgage Bonds	1,365,300
Series of Gold Notes	10,000,000
8% Dividend Certificates	8,058,831

Dupont, I. E., de Nemours & Company:

Common stock	63,378,300
Debenture Stock	71,243,250
10 Year Gold Bonds	35,000,000

Galena Signal Oil Company:

Common Stock	16,000,000
Preferred Stock	2,000,000
New Preferred Stock	4,000,000
Convertible Debenture	6,000,000
Entire Stock of Subsidiary Companies	2,800,000
Galena Signal Oil of Texas Bonds	2,800,000

General Electric Company:

Common Stock	176,329,100
Debenture for Sprague Stock	2,047,000
Debenture	15,136,500
Debenture Bonds	15,000,000

Kelly Springfield Tire Company:

Common Stock	\$9,096,002
Preferred Stock	3,137,100
Second Preferred	5,625,200
10 Year s. f. Gold Notes	10,000,000

Morris Company:

1st Mortgage	17,626,000
10 Year s. f. Gold Notes	15,000,000
Wm. F. Mosser Co. 10 yr. s. f. notes	3,000,000

Swift & Company:

Common Stock	150,000,000
1st Mortgage s. f. Gold Bonds	28,923,500
Gold Notes	65,000,000

Texas Company:

Stock	164,450,000
3 yr. S. F. Notes	22,772,000

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Final Decree.

Filed Nov. 13, 1922.

In the District Court of the United States for the Eastern District of
North Carolina, Raleigh Division.

Equity. No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY

vs.

A. D. WATTS and A. D. WATTS, as Commissioner of Revenue, and
JAMES S. MANNING, Attorney General of North Carolina.

Decree.

This is a suit in equity, brought by plaintiff, Norfolk Southern Railroad Company, a corporation chartered and organized under the laws of the State of Virginia, operating a line of railway in and through the State of North Carolina and the Eastern District thereof, against defendant, A. D. Watts, individually, and as Commissioner of Revenue of North Carolina and James S. Manning, Attorney General of said State, seeking an injunction restraining and enjoining said defendants from taking or causing to be taken any action toward enforcing the filing of a return or the collection of a tax or any part thereof, imposed, or sought to be imposed by the State of North Carolina, upon the plaintiff, under or by virtue of the provisions of the Public Laws of North Carolina of 1921, Chapter 34, known as the Revenue Act or the Income Tax Act, as amended by the General Assembly of North Carolina at its Special Session of 1921.

Following the service of process on the defendants and filing answer to the bill, the cause was set down for hearing upon the bill, answer and evidence.

Plaintiff alleges that, by the provisions of Article 5, Section 3 of the Constitution of North Carolina, the General Assembly is authorized to pass laws.

"Taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise, and also real and

personal property, according to its true value in money. * * *

The General Assembly may also tax trades, professions and incomes.

110 Provided the rate of tax on incomes shall not, in any case, exceed six per cent, and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes to-wit: For a married man, with a wife living with him, or to widow or widower having minor child or children, natural or adopted, not less than \$2,000.00; to all other persons not less than \$1,000; and there may be allowed other deductions (not including living expenses), so that net incomes are taxed."

Pursuant to the provisions of the foregoing Art. of the Constitution, the General Assembly, at its Session of 1921, enacted a statute providing for levying, collecting and paying an income tax on individuals and corporations. Chap. 34 Public Laws of North Carolina and known as a part of the Revenue Act of 1921, or, so far as it relates to the Income Tax, as the "Income Tax Act of 1921."

The sections of this Act pertinent to the questions presented for decision by the plaintiff's contention are:

Section 101. Purpose.—

"The general purpose of this act is to impose a tax for use of the State Government, upon the net income for the calendar year 1921, in excess of exemptions herein set out, collectible in the year 1922 and annually thereafter:

(a) Of every citizen of the State.

(b) Of every domestic corporation.

(c) Of every foreign corporation and of every non resident individual having a business or agency in this State in proportion to the net income of such business or agency.

"Except as otherwise provided in this Act, the purpose is to conform to the definitions of income in the revenue laws of the United States Government and regulations made under its authority in so far as they apply."

"The tax imposed upon the net income of corporations in this schedule is in addition to the tax imposed under Schedule "C" of this Act."

Section 201. Corporations.—

Every corporation organized under the laws of this State shall pay annually an income tax equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules.

In case of a Company other than Companies mentioned in the next succeeding section, deriving profits principally from the owner-

ship, sale or rental of real estate or from the manufacture, sale or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property, in this State, on the date of the close of the fiscal year of such Company in the income year is to be the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

In case of a corporation deriving profits principally from the holding or sale of intangible property such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State.

"Section 202. Railroads and public service corporations.—

"The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporations as shown by their records kept in accordance with that Standard Classification of Accounts, when their business is wholly within this State and when their business is in part within and in part without this State, including in their gross 'operating revenues' within this State the equal mileage proportion within this State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of operating expenses' or 'operating ratio', for their whole business, as shown by the Interstate Commerce Commission Standard Classification of Accounts. From the net operating income thus ascertained shall be deducted 'uncollectible revenue' and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this Act."

The foregoing section relating to the basis of ascertaining the net income of railroads was supplemented by Chapter 35 of the Public Laws of 1921, as follows:

"Sec. 1. That in determining the taxable income of a corporation engaged in the business of operating a railroad under section two hundred and two of the act to raise revenue, in the case of a railroad located entirely within this State, the net operating income shall be increased or decreased to the extent of any credit or debit balance received or paid, as the case may be, on account of car hire, and when any railroad is located partly within and partly without this State, then said net operating income shall be increased or decreased to the extent of an equal mileage proportion within this State of any credit or debit balance received or paid, as the case may be, on account of car hire."

112 Section 203 of the Income Tax Act of 1921, as amended by Chapter 35, Public Laws of 1921, is as follows:

"Section 203. Such tax shall first be levied, collected and paid in the year 1922, and with respect to the net income received during the calendar year 1921, and annually thereafter."

Section 3 of Chapter 34, Public Laws of 1921, provides:

"No tax on any property in the State shall be levied for any of the uses of the State Government. The taxes hereinafter levied in this act are for the expenses of the State Government, the appropriations to its educational, charitable and penal institutions, pensions for Confederate Soldiers and widows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer."

"Section 306. Deductions.—

"In computing net income there shall be allowed as deductions:

"1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business, including:

"(a) As to individuals, wages or employees for services actually rendered in producing such income.

"(b) As to partnerships, wages of employees and a reasonable allowance for co-partners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the co-partner receiving same.

"(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

"2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

"3. All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

"4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

113 "5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this

Act: Provided, that when only part of the income of any corporation shall have been assessed under this act, only a corresponding part of the dividends received therefrom shall be deducted.

"6. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

"7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

"8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that in computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits, the cost of development, not otherwise determined) and in the case of property acquired prior to January 1, 1921, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of costs up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases the deductions allowed may be equitably apportioned between the lessor and lessee.

"9. In the case of taxpayers who keep regular books of account, upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall, at any time, deem the reserve excessive in amount, it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

"10. Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inure to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision.

"11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such net income. The deductions authorized in this subsection shall in no case extend to any part of income or resident individuals from personal services or mortgages, stocks, bonds, securities and deposits.

114 "12. In the case of a non-resident individual, the deductions allowed in this section shall be allowed only if, and to

the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission.

Complainant is engaged in operating an interstate railroad and keeps its accounts in accordance with the Standard Classification of Accounts prescribed by the Interstate Commerce Commission and is required to pay an income tax under the appropriate part of Section 202 of The Income Tax Act or suffer the penalties prescribed in said Act.

Complainant respectfully shows the Court that the said Act is void as to complainant for the following reasons:

(a) Article 5, Section 3 of the Constitution of North Carolina authorizes the levy of a tax upon net incomes, and the statutory method prescribed in Section 202 for complainant and like corporations in order to arrive at net income results in the tax being levied on a sum which is not in truth and in fact net income, but includes a part of complainant's operating revenue in this:

Section 202 provides that railway corporations in the class of complainant shall first arrive at gross operating revenue within the State of its interstate business, and from this gross revenue shall deduct the following items:

(1) Proportionate average of operating expenses, as shown by the Interstate Commerce Commission Standard Classification of Accounts.

(2) Uncollectible revenue.

(3) Taxes paid in North Carolina for the income year, other than taxes and war profits and excess profits taxes.

(4) An equal proportion of car hire.

Plaintiff alleges that defendants, unless restrained by order of this Court will, pursuant to the provisions of the Statutes in force in the State of North Carolina, levy upon and assess against it the income taxes for the year 1922 and certify such levy and assessment to the officers charged with the enforcement and collection thereof, amounting to a large sum in excess of \$3,000.00 to-wit, the sum of \$19,616.46, whereas plaintiff avers that if it is allowed the deductions to which it is entitled it would not have any taxable income because the sum of such deductions is greater than its gross income, and that unless said taxes are paid within the time fixed by the Statute, plaintiff will be subjected to heavy penalties and that the levy of such taxes will constitute a lien upon its property and thereby a cloud upon its title thereto, and that plaintiff will suffer other and irreparable damage, etc., all of which will appear by reference to the allegations set out in its bill herein. The plaintiff's bill seeking an injunction, restraining defendants in the discharge of the official duties imposed by the Statute is based

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upon the allegation that the sections of the Revenue Act of 1921, and especially upon those sections known as the "Income Tax Act" violate the Constitution of the State of North Carolina and of the United States for that among other reasons:

1st. The tax levied as directed by said Statute is not a tax on net incomes but is levied upon gross income, or real net operating income and hence is repugnant to the State Constitution and to the Commerce Clause of the Federal Constitution.

2nd. The classification made by Section 202 of the Act as to method of ascertainment of net income for plaintiff and other corporations within the designed class is arbitrary, without reasonable or practical basis and hence is repugnant to the Uniformity Clause, Art. 5, Sec. 3 of the State Constitution and the Equal Protection Clause of the Fourteenth Amendment to the Constitution of the United States.

That it is a violation of the State Constitution for the general property tax to be devoted to local purposes and the various exercise, privilege, franchise, license, and income taxes to be devoted to State purposes.

That the income tax is invalid because it is levied in addition to property and franchise taxes. That the method of ascertaining the taxable income of plaintiff fixed or prescribed by Sec. 202 of the Act violates the provisions of Art. 5, Sec. 3 of the State Constitution and of the Fourteenth Amendment to the Federal Constitution, for that such method is not applied to such railroads or other public service corporation which do not operate their properties but have income only from rentals paid *them* by other companies to whom they lease their entire properties to be operated by the lessees.

It is pertinent, in view of the questions presented by the bills and answers and the prayer for injunctive relief to note the provisions of Section 700-701 of the Income Tax Act as amended by the Act of 1921, creating the office known as Commissioner of Revenue, providing for the prescribing the procedure in applications for revision and appeal from assessments and levies of taxes against all persons or corporations having property in, or being liable for, tax in the State.

The Legislature at its Special Session of 1921, made further provisions for refunding any taxes of any kind which have been through clerical error or misinterpretation or otherwise, collected or paid into the State Treasury in excess of the amount legally due the State and directing the State Auditor to issue his warrant for the amount so illegally collected to the person entitled thereto, upon certificate of the head of the department through which said taxes were collected or his successor in the performance of the functions of that department, with the approval of the Attorney General and the Treasurer to pay the sum out of any funds in the treasury not otherwise appropriated.

Upon consideration of the bill and answer, Exhibits and evidence, it is

Adjudged and decreed that plaintiff is not entitled to have the

defendants or either of them enjoined and restrained from the performance of the duties imposed upon them by the Statutes of North Carolina, relating to the administration, assessing, levying and enforcement or collection of the income tax against plaintiff. That the bill be dismissed. That defendants recover their cost to be taxed by the Clerk.

This the 7th day of November, 1922.

At Wilson, N. C.

H. G. CONNOR,
U. S. District Judge.

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Notice of Appeal.

Filed Nov. 16, 1922.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Plaintiff,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Notice of Appeal.

To the defendants in the above-entitled action and Honorable James S. Manning, Attorney General of North Carolina, and Frank Nash, Assistant Attorney General, Solicitors for defendants:

You will please take notice that, on Friday, November 17th, 1922, at 10:00 o'clock A. M., or as soon thereafter as counsel may be heard, the above named plaintiff will apply to his Honor, Henry G. Connor, District Judge, at the United States Court Room, Wilmington, N. C., for an order allowing plaintiff to appeal to the Supreme Court in the above cause, and granting a stay of proceedings until the appeal shall have been heard, passed upon and disposed of by the Supreme Court of the United States.

ATLANTIC COAST LINE RAILROAD
COMPANY,

By THOMAS W. DAVIS,
Solicitor.

Service accepted this 16th day of November:

JAMES S. MANNING,
*Attorney General of North Carolina
and Solicitor for Defendants.*

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Order Granting Thirty Day Stay.

Filed Nov. 18th, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY

vs.

A. D. WATTS, as Commissioner of Revenue of North Carolina, and
Others.

Income Tax Suit.

It is ordered that the defendants shall not proceed to enforce the collection of taxes involved in this litigation for the period of thirty days from the date of this order, to the end that complainant may take such action in the premises as it is advised to.

Dated at Wilmington, North Carolina this the 17th day of
November, 1922.

H. G. CONNOR,
U. S. Judge.

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Assignment of Errors.

Filed Nov. 27, 1922.

In the District Court of the United States for the Eastern District of
North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Individually and as Commissioner of Revenue of
North Carolina, et al., Defendants.

Assignment of Errors.

Comes now the complainant in the above entitled cause, and in connection with his petition for appeal from the final decree made November 7, 1922 and filed November 13, 1922 by said Court, deny-

ing complainant's motion for an injunction and dismissing its bill of complaint, files the following assignment of errors:

The Court erred:

(1) In decreeing that an injunction be denied to complainant and in dismissing its bill.

(2) In holding that for the purpose of its application for an injunction complainant was not entitled under its pleadings and proof to have such injunction.

(3) In failing and refusing to hold that complainant is denied the equal protection of the law and deprived of its property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States by the taxation of its income under North Carolina Income Tax Act of 1921, in that said Income Tax Act arbitrarily and unreasonably allows certain deductions to other corporations not public service corporations which are denied to railroad companies and other public service corporations.

(4) In failing to hold that the North Carolina Income Tax Act of 1921, both by its direct provisions and as sought to be applied to complainant operates as a direct burden upon interstate commerce, contrary to Section 1, Article 8 of the Constitution of the United States relating to the regulation of interstate commerce, in that said Income Tax Act does not tax the true net income of railroad companies, but imposes a tax in part upon gross income of such companies which derived from interstate commerce.

(5) In failing to hold that said Income Tax Act of 1921, in its operation and attempted application to complainant denies complainant the equal protection of the law in violation of the Fourteenth Amendment to the Constitution of the United States, and unlawfully discriminates against complainant in that it in fact taxes in part the gross income of complainant and other railroad corporations and taxes such income on a wholly different basis from that of other corporations not public service corporations, without any reasonable basis or ground for such distinction and discrimination.

(6) In failing and refusing to hold that the income tax imposed by said Income Tax Act of 1921 is not arrived at by a uniform rule as required by Section 3, Article 5 of the Constitution of North Carolina, and that such lack of uniformity greatly discriminates against and operates to the detriment of complainant in violation of the Fourteenth Amendment to the Constitution of the United States relating to the equal protection of the law and taxation of property without due process of law.

(7) In failing to hold that the method of taxing complainant's taxable income as provided by Section 202 of said Income Tax Act of 1921 violates the Constitution of North Carolina and denies complainant the equal protection of the law in violation of the Fourteenth Amendment to the Constitution of the United States, in that it does

not apply to railroads and other public service corporations which derive their income from sources other than the operation for
121 their property, thereby resulting in unlawful and unjust discrimination against complainant and other railroad companies.

(8) In failing to hold that the system of taxation existing in North Carolina particularly with respect to interstate railroad corporations by which various taxes are pyramided one upon the other, thus taxing several times the same elements of property under various names such as ad valorem taxes on both tangible and intangible property and so called privilege taxes and income taxes, operates as a regulation of an undue burden upon interstate commerce in violation of Section 8, Article 1, Constitution of the United States.

(9) In failing to hold that said Income Tax Act of 1921 denies complainant the equal protection of the law and deprives it of its property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States, in that said Tax Act violates and departs from the scheme of taxation imposed by the Constitution of North Carolina by reason of the fact that, whereas the North Carolina Constitution requires that all property shall bear its just proportion of taxation and be taxed by uniform rule, large classes of property are by said laws exempted from taxation for said purposes and such loss of revenue to the State is recouped by the imposition of said Income Tax solely for said purposes; thereby imposing an additional burden upon and unlawfully discriminating against complainant.

(10) In failing to hold that said Income Tax Act of 1921 is unconstitutional and void and in violation of the Fourteenth Amendment to the United States Constitution as denying the equal protection of the law, in that it is retroactive to the extent that attempts to tax income for January, February and part of March, 1921, when said Act only became effective from its ratification on March 8, 1921.

122 (11) In failing to hold that said Income Tax Act of 1921, and particularly Section 600 thereof, was and is unconstitutional and void as denying to complainant due process of law in violation of the Fourteenth Amendment to the Constitution of the United States, for the reason that it imposed excessive and unreasonable penalties for a failure to pay taxes levied under said Act, namely, a penalty of double the amount of the tax; said excessive and unreasonable penalties being calculated to deter persons sought to be taxed, under the Act from testing the validity of same by judicial proceedings.

(12) That said Act does not provide a method for the taxation of income of the complainant as required by the Constitution of the State, or by uniform rule as compared with the income of other citizens, residents, persons or corporations doing business in the State of North Carolina and subject to an income tax, but is really an

attempt to enforce against Atlantic Coast Line Railroad Company, and other interstate carriers of the State of North Carolina and of the United States, engaged in interstate commerce, the payment of a tax on account of and for the reason that this complainant, and other companies similarly situated, are engaged in the business of conducting and carrying on interstate commerce by attempting through an unjust, unreasonable and illegal classification to require complainant and other railroad companies doing business in the State of North Carolina and engaged in interstate commerce, to pay an income tax upon more than their net income, while all other tax payers are taxed upon their net income.

(13) That the assessment for income tax made by the defendant A. D. Watts, as Commissioner of Revenue, against the complainant was not made upon the net income of this complainant, but was made upon what was termed its "net operating income," while all other individuals and corporations doing business in the State of

123 North Carolina and subject to income tax had their income tax assessed upon the basis of their net income, except corporations engaged in the business of operating steam or electric railroads, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission.

That the said assessment of the income tax made by the defendant A. D. Watts, as Commissioner of Revenue of North Carolina, was illegal and void, as being made upon a classification of complainant and other public service corporations engaged in interstate commerce and required to report to the Interstate Commerce Commission, and to keep their records in accordance with the orders of that Commission, and thereby imposed, or undertook to impose a tax upon the complainant by reason of the fact that it was engaged in interstate commerce, which tax is greater than would be imposed upon complainant if it were not engaged in such interstate commerce, and undertook to classify, for the purpose of an income tax and of ascertaining what constituted net income, taxpayers into two classes, to wit: Those engaged in interstate commerce in the operation of public service, as common carriers and all other taxpayers in the other class. That such classification was and is in violation and contravention of the Constitution of the United States, especially of the interstate commerce clause of Section 8, Article I; of Section 2, Article IV, and of Section 1, Article XIV, and is in violation and contravention of the Constitution of the State of North Carolina, especially Section 5, Article V thereof.

THOMAS W. DAVIS,
Solicitor for Complainant.

Y24

Stipulation of Counsel as to the Record.

Filed Dec. 5th, 1922.

In the District Court of the United States for the Eastern District
of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Stipulation of Counsel as to Record.

It is stipulated and agreed by and between the parties to the above
entitled cause:

That the Clerk, in making up the transcript of record on this
appeal from the decree of the District Court shall include—

Bill of complaint and exhibits.

Application for interlocutory injunction.

Order on application for interlocutory injunction.

Notice of hearing on application for interlocutory injunction.

Answer.

Affidavit of J. H. Bridgers with exhibits.

Affidavit of Nathan O'Berry.

Affidavit of C. D. Bradham.

Affidavit of A. R. Turnbull.

Affidavit of J. C. Nelms.

Affidavit of J. C. Nelms.

Affidavit of J. C. Nelms.

Affidavit of F. C. Harding.

Affidavit of C. J. Joseph.

Affidavit of H. C. Prince without exhibits.

Affidavit of M. S. Hawkins.

Affidavit of E. H. Kemper.

Affidavit of O. S. Thompson.

Affidavit of A. J. Maxwell.

Affidavit of R. O. Self.

Testimony and exhibits.

Certificate of Corporation Commission as to certain lumber cor-
porations, and others licensed as common carriers and engaged in
intrastate commerce in North Carolina.

Notice of appeal.

Petition for appeal.

Assignments of error.

Order allowing appeal and granting supersedeas and stay.

Bond and Citation.

The exhibits attached to the affidavit of H. C. Prince are summarized in the affidavit of J. C. Nelms.

It is further stipulated that the Clerk may use in preparing the record on appeal printed copies of all such pleadings, documents, affidavits, etc., as may be furnished by the parties hereto.

THOS. W. DAVIS,

Solicitor for Complainant;

GEO. H. BROWN,

Of Counsel, Solicitor for Defendants;

Attorney General of N. C.

125 *Memorandum of Original Papers Certified Separately.*

Petition for Appeal filed Nov. 27, 1922.

Appeal allowed Nov. 27, 1922.

Appeal Bond dated Dec. 5, 1922; penalty, \$1,000.00; Obligors: Atlantic Coast Line Railroad Company and Fidelity & Deposit Company of Maryland; Conditioned for damages and costs.

Citation dated Nov. 27th, 1922; service accepted by George H. Brown, of Counsel for Defendants, Nov. 27, 1922.

126 *Order to Transmit Record.*

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

#448.

ATLANTIC COAST LINE RAILROAD COMPANY

vs.

A. D. WATTS, Commissioner of Revenue, et als.

And thereupon it is ordered by the Court here that a transcript of the record and proceedings in said suit be transmitted to the United States Supreme Court at Washington, D. C., and the same is transmitted accordingly.

S. A. ASHE,

Clerk United States District Court.

In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY,

vs.

A. D. WATTS, Commissioner of Revenue, et als.

I, S. A. Ashe, Clerk, United States District Court, for the Eastern District of North Carolina, do hereby certify that the foregoing pages present a full, true and correct copy of the proceedings had and order entered in that certain suit in equity pending in said Court, wherein Atlantic Coast Line Railroad Company is complainant and A. D. Watt, Commissioner of Revenue of North Carolina, and others, are defendants.

In testimony whereof, I have hereunto set my hand and affixed the seal of the said District Court at the Courthouse in Raleigh, State of North Carolina, this 6th day of December, 1922.

[United States District Court, Eastern District of N. C. at Raleigh.]

S. A. ASHE,

Clerk United States District Court.

128 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Petition for Appeal.

To the Honorable Henry G. Connor, District Judge of the United States in and for the Eastern District of North Carolina;

The Atlantic Coast Line Railroad Company, Complainant herein, feeling itself aggrieved by the decree of the Court made and entered in this cause on November 7, 1922 and filed on November 13, 1922,

refusing and denying the injunction applied for in this cause to restrain and enjoin defendants as prayed for in complaint, does hereby appeal to the Supreme Court of the United States from said decree, refusing and denying said injunction applied for and dismissing its complaint, upon the grounds set forth in the Assignment of Errors filed herewith, and the Complainant prays that its appeal be allowed and that citation issue as provided by law and that a transcript of the record, proceedings, and documents upon which said decree is based duly authenticated, be sent to the Supreme Court of the United States, under the rules of such Court in such cases made and provided.

And Complainant further prays that the Court enter an order staying and superseding all proceedings by defendants or either of them against Complainant for the collection of taxes involved in this litigation, until the appeal herein prayed for shall have been passed upon and disposed of by the United States Supreme Court, and that a proper order *be* made touching the security to be required of Complainant to perfect its appeal and as a condition to said stay.

ATLANTIC COAST LINE RAILROAD
COMPANY.

By THOS. W. DAVIS,
Solicitor.

131 [Endorsed:] #448 Eq. District Court of the United States Eastern District of North Carolina, In Equity No. 448. Petition for Appeal. Atlantic Coast Line Railroad Company, Complainant, vs. A. D. Watts, Commissioner of Revenue of North Carolina, et al., Defendants. I certify that the within is entered and filed this day. Nov. 27, 1922. S. A. Ashe, Clerk, *Clerk*. Petition for Appeal.

132 & 133 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

Order Allowing Appeal and Granting Supersedeas and Stay.

This cause coming on to be heard upon the application of complainant, Atlantic Coast Line Railroad Company, for an appeal to the Supreme Court of the United States, and for a supersedeas and order staying and restraining the collection of the income tax involved in this suit and alleged to be illegal in the complaint filed

herein, until the determination of the appeal in this cause now pending in the Supreme Court of the United States, and complainant being represented by Thomas W. Davis, its attorney, and the defendants by their attorneys, Frank Nash, Assistant Attorney General of North Carolina, and George H. Brown, the appeal prayed for is hereby granted, Appeal Bond in the sum of \$1,000.00 to be filed.

And the Court being of the opinion that the status quo between the parties should be preserved pending such determination of appeal by the complainant to the Supreme Court of the United States:

It is, therefore, decreed and adjudged that defendants, their agents, servants and employees and each of them be and are hereby restrained from collecting or attempting to collect from complainant the income tax which is the subject matter of this suit, pending the determination of the appeal by the complainant in this cause now pending in the United States Supreme Court.

It is further ordered and decreed that complainant do give bond, with good and sufficient surety, in the sum of Ten Thousand Dollars, to be approved by the Judge of the United States Court, or the Clerk of said Court, conditioned to pay to said defendants all of such income tax that may finally be determined in this cause to be legally due and payable by the complainant to the defendants.

Dated this 27th day of November, 1922.

H. G. CONNOR,

District Judge, Eastern District of North Carolina.

134 [Endorsed:] J. 448, Equity. Atlantic Coast Line Railroad Company vs. A. D. Watts, et als. Order Allowing Appeal & Granting Supersedeas & Stay under \$10,000 Bond. I certify that the within is entered and filed this day. Nov. 27, 1922. S. A. Ashe, Clerk.

135 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,
vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.
Defendants.

Appeal Bond.

Know all men by these presents: that we, Atlantic Coast Line Railroad Company, a corporation organized and existing under the laws of the State of Virginia, as principal, and Fidelity and Deposit Company of Maryland, as surety, are held and firmly bound unto the above named A. D. Watts, and the other defendants in the sum of One Thousand Dollars (\$1,000.00) to be paid to the said A. D. Watts

and other defendants, their successors and assigns, to which payment, well and truly to be made, we bind ourselves and our successors jointly and severally by these presents.

Sealed with our seals this 5th day of December, 1922.

Whereas, in a suit pending in the District Court of the United States for the Eastern District of North Carolina between Atlantic Coast Line Railroad Company, complainant, and A. W. Watts, et al., defendants, a final decree was rendered by the Court denying complainant the relief prayed for and dismissing the bill of complaint and the said Atlantic Coast Line Railroad Company having prayed and been allowed an appeal direct to the Supreme Court of the United States, and filed a copy thereof in the Clerk's Office of the said Court, and citation having issued directed to the A. D. Watts, et al., citing and admonishing them to be and appear in the Supreme Court of the United States within the time required by law.

Now the condition of the above obligation is such that if the said Atlantic Coast Line Railroad Company shall prosecute its said appeal to effect and answer all damages and costs if it fails to make its appeal good, then the above obligation shall be void, else to remain in full force and effect.

ATLANTIC COAST LINE RAILROAD
COMPANY,

By THOS. W. DAVIS,

Attorney in Fact.

[Seal of the Fidelity & Deposit Company of Maryland, Incorporated 1890.]

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND,

By THEODORE S. JAMES,

Attorney in Fact.

Approved Dec. 6, 1922.

H. G. CONNOR,

Judge.

136 & 137 The President stated that the late General Solicitor P. A. Willeox, had been given authority by this Board to sign bonds on behalf of this Company required in legal proceedings in the States of North Carolina and South Carolina, and it is now desired to transfer this authority to his successor, Thomas W. Davis.

Whereupon, on motion duly made and seconded, it was unanimously

Resolved, that Thomas W. Davis, of Wilmington, North Carolina, be and is hereby authorized as Agent and Attorney in Fact of Atlantic Coast Line Railroad Company to sign, execute and deliver on behalf of said Company bonds and other instruments required in Court and other legal proceedings in the States of North Carolina and South Carolina.

I, R. D. Cronly, Assistant Secretary of the Atlantic Coast Line Railroad Company, do hereby certify that the above and foregoing is a correct excerpt from the minutes of meeting of the Board of Directors of the Atlantic Coast Line Railroad Company, duly called and held at 71 Broadway, in the City of New York, N. Y., on the twentieth day of April, 1922, at which a quorum was present and voted.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said Atlantic Coast Line Railroad Company this twenty-second day of November, 1922.

[Seal of the Atlantic Coast Line Railroad Company.]

R. D. CRONLY,
Assistant Secretary.

138 [Endorsed:] #448. Eq. District Court of the United States, Eastern District of North Carolina. In Equity, No. 448. Atlantic Coast Line Railroad Company, Complainant, vs. A. D. Watts, Commissioner of Revenue of North Carolina, et al., Defendants. Appeal Bond. I certify that the within is entered and filed this day, Dec. 6, 1922. S. A. Ashe, Clerk.

139 & 140 In the District Court of the United States for the Eastern District of North Carolina.

In Equity.

No. 448.

ATLANTIC COAST LINE RAILROAD COMPANY, Complainant,

vs.

A. D. WATTS, Commissioner of Revenue of North Carolina, et al.,
Defendants.

The United States of America to A. D. Watts, as Commissioner of Revenue of North Carolina, and James S. Manning, as Attorney General of North Carolina, Greeting:

Whereas, Atlantic Coast Line Railroad Company has lately appealed to the Supreme Court of the United States from a decree lately rendered in the District Court of the United States for the Eastern District of North Carolina, made in favor of you, the said Atlantic Coast Line Railroad Company having filed the security required by law, you are therefore hereby cited to appear before the said Supreme Court of the United States at the City of Washington on the 27th day of December next, to do and receive what may appertain to justice to be done in the premises.

Given under my hand at the City of Raleigh in the Fourth Circuit, this the 27th day of November, in the year of our Lord, One Thousand Nine Hundred and Twenty Two.

H. G. CONNOR,
*Judge of the District Court of the United
States for the Eastern District of North
Carolina.*

Service accepted.

GEO. H. BROWN,
Of Counsel for Defts.

Nov. 27, 1922.

I certify that the within is entered and filed this day.

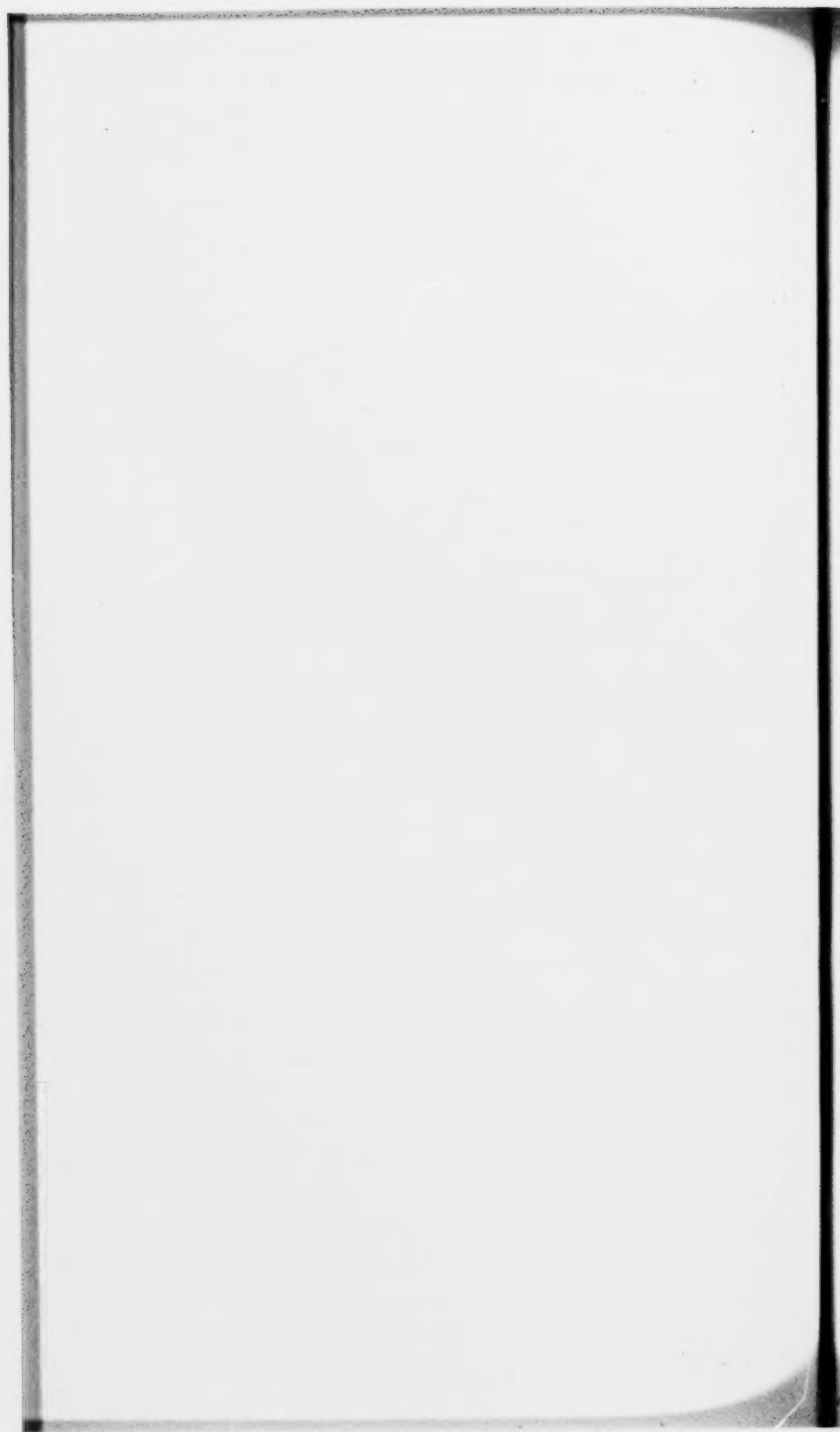
Nov. 27, 1922.

S. A. ASHE,
Clerk.

141 [Endorsed:] (J.) #448, Equity. Atlantic Cost Line Railroad Company vs. A. D. Watts et als. Citation and acceptance of service. I certify that the within is entered and filed this day. Nov. 27, 1922. S. A. Ashe, Clerk.

Endorsed on cover: File No. 29,274. E. North Carolina D. C. U. S. Term No. 724. Atlantic Coast Line Railroad Company, appellant, vs. A. D. Watts, Commissioner of Revenue of the State of North Carolina, et al. Filed December 9th, 1922. File No. 29,274.

(8245)



FILED

MAR 19 1923

WM. E. STANBRUP

IN THE
Supreme Court of the United States

OCTOBER TERM, 1922.

No. 724.

ATLANTIC COAST LINE RAILROAD
COMPANY, Appellant,
vs.

A. D. WATTS, INDIVIDUALLY AND AS
COMMISSIONER OF REVENUE OF
NORTH CAROLINA, ET AL., Appellees.

**Motion for Leave to Substitute R. A. Doughton,
Commissioner of Revenue of North Carolina, for
A. D. Watts, Commissioner of Revenue of North
Carolina.**

THOS. W. DAVIS,
Counsel for Appellant.

March 19, 1923.



IN THE
Supreme Court of the United States

OCTOBER TERM, 1922.

No. 724.

ATLANTIC COAST LINE RAILROAD
COMPANY, Appellant,

vs.

A. D. WATTS, INDIVIDUALLY AND AS
COMMISSIONER OF REVENUE OF
NORTH CAROLINA, ET AL., Appellees.

Comes the Appellant, Atlantic Coast Line Railroad Company, and moves the Court to substitute R. A. Doughton as one of the Appellees in this cause in place of A. D. Watts, and, for grounds of said motion, respectfully shows:

A. D. Watts, individually and as Commissioner of Revenue of the State of North Carolina, together with James S. Manning, Attorney General of North Carolina, were the original defendants herein. A. D. Watts resigned the office of Com-

missioner of Revenue on January 29, 1923, and was on January 29, 1923, succeeded in office by R. A. Doughton, who now holds said office.

Wherefore, Appellant prays that R. A. Doughton be substituted for A. D. Watts.

THOS. W. DAVIS,
Attorney for Appellant.

The undersigned, James S. Manning, Attorney General of the State of North Carolina, and representing R. A. Doughton, the present Commissioner of Revenue of North Carolina, consents for said R. A. Doughton to the substitution hereinabove moved for.

JAMES S. MANNING,
Attorney for R. A. Doughton.

FILED
MAR 26 1923

WM. R. STANSBURY
CLERK

IN THE
Supreme Court of the United States

OCTOBER TERM, 1922

NO. 724

ATLANTIC COAST LINE RAILROAD COMPANY,
Appellant,

against

A. D. WATTS AND A. D. WATTS AS COMMISSIONER
OF REVENUE, ET AL;

Appellee.

IN EQUITY

APPEAL FROM THE DISTRICT COURT OF THE
UNITED STATES FOR THE EASTERN DISTRICT
OF NORTH CAROLINA.

BRIEF OF APPELLANT.

THOMAS W. DAVIS,
Solicitor for Appellant.
Wilmington, N. C.

GEORGE B. ELLIOT,
HARRY SKINNER,

Of Counsel.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1922

NO. 724

ATLANTIC COAST LINE RAILROAD COMPANY,
Appellant,
against

A. D. WATTS AND A. D. WATTS AS COMMISSIONER
OF REVENUE, ET AL.

Appellee.

IN EQUITY

APPEAL FROM THE DISTRICT COURT OF THE
UNITED STATES FOR THE EASTERN DISTRICT
OF NORTH CAROLINA.

BRIEF OF APPELLANT.

(Italics ours except where otherwise stated)

STATEMENT OF CASE

This suit was brought in the United States District Court for the Eastern District of North Carolina to enjoin the collection of an Income Tax of three per cent levied on plaintiff under what is known as the Income Tax Law of North Carolina, passed at the session of the Legislature of that State in

1921, upon the ground that the act violates the Constitution of the State of North Carolina and the Constitution of the United States.

We will hereafter more fully set out the contentions and the grounds upon which the injunction is asked and the act claimed to be unconstitutional.

The case was heard by the District Judge who rendered a decree adjudging that plaintiff was not entitled to an injunction and ordering the bill dismissed. The decree sets forth the contentions of the plaintiff, but does not set out any reasons for the dismissal of the bill.

CLAUSES OF CONSTITUTION AND STATUTES

Article 5, Section 3, of the Constitution of North Carolina, which authorizes the levy of an income tax is in the following words:

“Laws shall be passed taxing, by a uniform rule, all moneys, credits, investments in bonds, stocks, joint-stock companies, or otherwise; and, also, all real and personal property, according to its true value in money: Provided, notes, mortgages, and all other evidence of indebtedness given in good faith for the purchase price of a home, when said purchase price does not exceed three thousand dollars, and said notes, mortgages, and other evidence of indebtedness shall be made to run for not less than five nor more than twenty years, shall be exempt from taxation of every kind: Provided, that the interest carried by such notes and mortgages shall not exceed five and one-half per cent. The General Assembly may also tax trades, professions, franchises, and incomes: *‘Provided, the rate of tax on incomes shall not in any case exceed six per cent (6%), and there shall be allowed the following exemptions, to be deducted from the amount of annual incomes, to-wit: For a married man with a wife living with him, or to a widow or widower having minor child or children, natural or adopted, not less than \$2,000; to all other persons not less*

than \$1,000, and there may be allowed other deductions (not including living expenses) so that only net incomes are taxed.' " (Italics Amendment of 1920).

Purporting to act under the authority of this article of the Constitution, the Legislature of North Carolina, at its regular session, 1921, enacted a law providing for the levying, collecting and paying of an income tax on individuals and corporations, being Chapter 34 of the Public Laws of North Carolina of 1921, and being a part of what is known as the Revenue Act of 1921.

The pertinent provisions of this income tax law are as follows:

Section 100 provides that the income tax schedule shall be known and cited as the Income Tax Act of 1921, and we will so refer to it in this brief.

Section 101 provides:

"Sec. 101. Purpose. The general purpose of this act is to impose a tax, for the use of the State Government, upon the net income for the calendar year 1921, in excess of exemptions herein set out, collectible in the year 1922, and annually thereafter: (a) Of every citizen of the State. (b) Of every domestic corporation. (c) Of every foreign corporation and of every non-resident individual having a business or agency in this State, in proportion to the net income of such business or agency.

Except as otherwise provided in this act the purpose is to conform to the definitions of income in the revenue laws of the United States Government and regulations made under its authority, in so far as they apply.

The tax imposed upon the net income of corporations in this schedule is in the nature of a franchise tax for the privileges granted by the State to domestic corporations and to foreign corporations doing business in this State, and is in addition to the tax imposed under Schedule C of this act."

Section 102 provides:

"Sec. 102. Definitions. For the purpose of this act and unless otherwise required by the context:

1. The words "Tax Commission" mean the State Tax Commission.

2. The word "taxpayer" includes any individual, corporation or fiduciary subject to the tax imposed by this act.

3. The word "individual" means a natural person.

4. The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporation, acting in any fiduciary capacity for any person, estate or trust.

5. The word "person" includes individuals, fiduciaries, partnerships and corporations.

6. The word "corporation" includes joint-stock companies or associations and insurance companies.

7. The words "domestic corporation" mean any corporation organized under the laws of this State.

8. The words "foreign corporation" mean any corporation other than a domestic corporation.

9. The words "tax year" mean the calendar year in which the tax is payable.

10. The words "income year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this act; if no fiscal year has been established they mean the calendar year.

11. The words "fiscal year" mean an income year, ending on the last day of any month other than December.

12. The word "paid" for the purposes of the deductions under this act means "paid or accrued" or "paid or incurred," and the words "paid or accrued," "paid or incurred," and "incurred," shall be construed according to the method of accounting upon the basis of which the net income is computed under this act. The word "received" for the purpose of the computation of the net

income under this act means "received or accrued," and the words "received or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this act.

13. The word "resident" applies only to individuals, and includes for the purpose of determining liability to the tax imposed by this act, with reference to the income of any income year, any individual who shall be a resident of the State on the first day of the tax year. In the absence of other satisfactory indicia the residence of a person who has two or more places in which he occasionally dwells may be determined with reference to the place at which the individual lived the longest period of time during the income year.

14. The words "foreign country" mean any jurisdiction other than one embraced within the United States. The words "United States," when used in a geographical sense, include the States, the Territories of Alaska and Hawaii, the District of Columbia, and the possessions of the United States."

Section 201 provides:

"Sec. 201. Corporations. Every corporation organized under the laws of this State shall pay annually a franchise or excise tax, with respect to carrying on or doing business, equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually a franchise or excise tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules:

This section was amended on December 19th, 1921, at the special session of the Legislature of North Carolina of 1921, being Chapter 102 of the Public Laws of North Carolina, Special Session 1921, as follows:

"Sec. 201. Corporations. Every corporation organized under the laws of this State shall pay annually an income tax equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules.

In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, sale, or use of tangible personal property, such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ended on the date of the close of its fiscal year next preceding is to its gross receipts for such year within and without the State."

Section 202 provides:

"Sec. 202. Railroads and public service corporations. The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporations as shown by their records kept in accordance

with that standard classification of accounts, when their business is wholly within this State, and when their business is in part within and in part without the State their net income within this State shall be ascertained by taking their gross 'operating revenues' within this State, including in their gross 'operating revenues' within this State the equal mileage proportion within this State of their interstate business and deducting from their gross 'operating revenues' the proportionate average of 'operating expenses,' or 'operating ratio,' for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted 'uncollectible revenue,' and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act."

Section 203 provides:

"Sec. 203. Such tax shall first be levied, collected, and paid in the year 1922, and with respect to the net income received during the calendar year 1921 or during any income year ending during the twelve months ending March 31, 1922."

Section 300 provides:

"Sec. 300. Net income defined. The words 'net income' mean the gross income of a taxpayer less the deductions allowed by this act."

Section 301 provides:

"Sec. 301. Gross income defined. 1. The words 'gross income' include gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property;

also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this act, any such amounts are to be properly accounted for as of a different period.

2. The words 'gross income' do not include the following items, which shall be exempt from taxation under this act.

(a) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

(c) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

(d) Interest upon the obligations of the United States or its possessions, or of the State of North Carolina.

(e) Salaries, wages, or other compensation received from the United States by officials or employees thereof, including persons in the military or naval forces of the United States.

(f) Any amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness."

Section 306 provides:

Sec. 306. Deductions. In computing net income there shall be allowed as deductions:

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business including:

(a) As to individuals, wages of employees for services actually rendered in producing such income.

(b) As to partnerships, wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the copartner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

3. All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted.

6. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil, and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that in computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits, the cost of development, not otherwise deducted), and in the case of property acquired prior to January 1, 1921, the fair market value of the property (or the taxpayer's interest therein) on that date shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the case of leases the deductions allowed may be equitably apportioned between the lessor and lessee.

9. In the case of taxpayers who keep regular books of account, upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall at any time deem the reserve excessive in amount it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

10. Contributions or gifts made within the taxable year to corporations or associations operated exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision.

11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such net income. The deduction authorized in this subsection shall in no case extend to any part of income of resident individuals from personal services, or mortgages, stocks, bonds, securities and deposits.

12. In the case of a nonresident individual, the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission."

Section 3 of the Revenue Act of 1921, provides as follows:

"Sec. 3. State taxes. No tax on any property in the State shall be levied for any of the uses of the State Government. The taxes hereinafter levied in this act are for the expenses of the State Government, the appropriations to its educational, charitable, and penal institutions, pensions for Confederate soldiers and widows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer."

Chapter 96, Public Laws of North Carolina, Extra Session 1921, provides:

"Section 1. Whenever taxes of any kind are or have been through clerical error, or misinterpretation of the law, or otherwise, collected and paid into the State Treasury in excess of the amount legally due the State, the State Auditor shall issue his warrant for the amount so

illegally collected, to the person entitled thereto, upon certificate of the head of the department through which said taxes were collected or his successor in the performance of the functions of this department, with the approval of the Attorney General, and the Treasurer shall pay the same out of any funds in the treasury not otherwise appropriate: Provided, demand is made for the correction of such error or errors within two years from the time of such payment: Provided further, that claims which have arisen within the five years next preceding the ratification of this act shall be presented and made within two years from the ratification of this act.

"Sec. 2. This act shall be in force and effect from and after its ratification.

"Ratified this 19th day of December, 1921."

ASSIGNMENTS OF ERROR

The formal assignments of error by plaintiff are found on pages 94 to 97 of the Record, but they may be summarized and abbreviated as follows:

1. The court erred in denying the injunction to plaintiff and dismissing the bill and in holding that for the purpose of its application for an injunction plaintiff was not entitled to it under its pleadings and proof. (Record, page 95).

2. The court erred in failing to hold that plaintiff is entitled to the equal protection of the law and deprived of its property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States by the taxation of its income under the North Carolina Income Tax Act of 1921, in that said Income Tax Act arbitrarily and unreasonably allows certain deductions to other corporations not public service corporations which are denied to railroads and other public service corporations, and in failing to hold that the said Income Tax Act discriminates against plaintiff in that it in fact taxes in part the gross income of plaintiff and other railroad corporations, and taxes such income on a

wholly different basis from that of other corporations not public service corporations, without any reasonable ground for such distinction and discrimination. (Section 3 and 5, Record page 95).

3. The court erred in failing to hold that the North Carolina Income Tax Act of 1921, both by its direct provisions and as sought to be applied to plaintiff operates as a direct burden upon interstate commerce, contrary to Section 1, Article 8, of the Constitution of the United States relating to the regulation of interstate commerce, in that said Income Tax Act does not tax the true net income of railroad corporations, but imposes a tax in part upon gross income derived from interstate commerce, and, further, for the reason, that the system of taxation existing in North Carolina with respect to interstate railroads by which the various taxes are pyramided one upon the other, thus taxing several times the same elements of property under various names such as ad valorem taxes on both tangible and intangible property and so-called privilege taxes and income taxes, which operate as a regulation of, and undue burden upon, interstate commerce in violation of Section 8, Article 1, of the Constitution of the United States. (Record, pages 95, 96).

4. The court erred in refusing to hold that the income tax imposed by said Income Tax Act is not arrived at by a uniform rule as required by Section 3, Article 5 of the Constitution of North Carolina, and that such lack of uniformity greatly discriminates against and operates to the detriment of plaintiff in violation of the Fourteenth Amendment to the Constitution of the United States, and in failing to hold that the method of taxing plaintiff's taxable income as provided by Section 202 of said Income Tax Act violates the Constitution of North Carolina and denied plaintiff the equal protection of the law in violation of the Fourteenth Amendment to the Constitution of the United States in that it does not apply to railroads and other public service corporations which derive their income from sources other than the operation of their

property, thereby resulting in unlawful and unjust discrimination against plaintiff and other railroad companies. (Record, pages 95, 96).

5. The court erred in failing to hold that said Income Tax Act denies plaintiff the equal protection of the law and deprives it of its property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States in that it violates and departs from the scheme of taxation imposed by the Constitution of North Carolina by reason of the fact that whereas the North Carolina Constitution requires that all property shall bear its just proportion of taxation and be taxed by uniform rule, large classes of property by said laws exempted from taxation for said purposes and such loss of revenue to the State is recouped by the imposition of said Income Tax solely for said purposes; thereby imposing an additional burden upon and unlawfully discriminating against plaintiff. (Record, page 95).

6. The court erred in failing to hold that said Income Tax Act, and particularly Section 600 thereof, was and is unconstitutional and void as denying to plaintiff due process of law in violation of the Fourteenth Amendment to the Constitution of the United States, for the reason that it imposed excessive and unreasonable penalties for the failure to pay taxes levied under said Act, namely, a penalty of double the amount of the tax; said excessive and unreasonable penalties being calculated to deter persons sought to be taxed, under the Act from testing the validity of same by judicial proceedings.

7. The court erred in failing to hold that said Act does not provide a method for the taxation of income of the complainant as required by the Constitution of the State, or by uniform rule as compared with the income of other citizens, residents, persons or corporations doing business in the State of North Carolina and subject to an income tax, but is really an attempt to enforce against Atlantic Coast Line Railroad Company, and other interstate carriers of the State of North Carolina and of the United States, engaged

in interstate commerce, the payment of a tax on account of and for the reason that this complainant, and other companies similarly situated, are engaged in the business of conducting and carrying on interstate commerce by attempting through an unjust, unreasonable and illegal classification to require complainant and other railroad companies doing business in the State of North Carolina and engaged in interstate commerce, to pay an income tax on more than their net income, while all other tax payers are taxed upon their net income.

8. The court erred in failing to hold that assessment for income tax made by the defendant A. D. Watts, as Commissioner of Revenue, against the complainant was not made upon the net income of this complainant, but was made upon what was termed its "net operating income," while all other individuals and corporations doing business in the State of North Carolina and subject income tax had their income tax assessed upon the basis of their net income, except corporations engaged in the business of operating steam or electric railroads, express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the Standard Classification of Accounting of the Interstate Commerce Commission.

That the said assessment of the income tax made by the defendant A. D. Watts, as Commissioner of Revenue of North Carolina, was illegal and void as being made upon a classification of complainant and other public service corporations engaged in interstate commerce and required to report to the Interstate Commerce Commission, and to keep their records in accordance with the orders of that Commission, and thereby imposed, or undertook to impose a tax upon the complainant by reason of the fact that it was engaged in interstate commerce, which tax is greater than would be imposed upon complainant if it were not engaged in such interstate commerce, and undertook to classify, for the purpose of an income tax and of ascertaining what constituted net income, taxpayers into two classes, to-wit: Those engaged in

interstate commerce in the operation of public service, as common carriers and all other taxpayers in the other class. That such classification was and is in violation and contravention of the Constitution of the United States, especially of the interstate commerce clause of Section 8, Article I; of Section 2, Article IV, and of Section 1, Article XIV, and is in violation and contravention of the Constitution of the State of North Carolina, especially Section 5, Article V thereof.

ARGUMENT

I.

JURISDICTION

The Federal Court has jurisdiction of this case.

(1) Upon the ground of diversity of citizenship, plaintiff being a citizen and resident of the State of Virginia, and defendants being citizens and residents of the State of North Carolina. See paragraphs 1 and 2 of Bill, Record, pages 2, 3).

That plaintiff is a citizen and resident of the State of Virginia, see the following cases:

Lee v. Atlantic Coast Line Railroad Company, 150 Federal, 775.

Atlantic Coast Line Railroad Company v. Dunning, (C. C. A 4th Circuit), 166 Federal, 850.

(2) The amount in controversy exceeds three thousand dollars. (Record, page 3).

(3) This court has jurisdiction regardless of citizenship. Section 24 of the Judicial Code.

(4) It is alleged in the bill that the taxes and assessments are in violation of the Fourteenth Amendment to the Constitution of the United States and the Commerce Clause of the Constitution of the United States, as well as in violation of the Constitution of North Carolina. (Paragraphs 3, 12, 13, 15, 16, 17, 18, 19, 20, 21, 22 of the Bill, Record, pages 3, 6, 9, 10, 11 and 12).

Section 504, Chapter 34, Public Laws of North Carolina, 1921, being the Revenue Act, provides:

"If any tax imposed by this act or any portion of such tax be not paid within sixty days after the same becomes due, the Tax Commission shall issue an order under its hand and official seal directed to the sheriff of any county of the State, commanding him to levy upon and sell the real and personal property of the taxpayer, found within his county, for the payment of the amount thereof, with the added penalties, interest, and the cost of executing the same and return to the Tax Commissioner the money collected by virtue thereof by a time to be therein specified, not less than sixty days from the date of the order. The said sheriff shall thereupon proceed upon the same in all respects, with like effect, and in the same manner prescribed by law in respect to the executions issued against property upon judgments of a court of record, and shall be entitled to the same fees for his service in executing the order, to be collected in the same manner. If an order be returned not satisfied in full, the Tax Commission shall have the same remedies to enforce the claim for taxes against the taxpayer as if the State had recovered judgment against the taxpayer for the amount of the tax."

This, therefore, casts a cloud upon the plaintiff's title to this property. Therefore, this court has jurisdiction to hear and determine this cause on all the grounds above set forth.

Wallace v. Hines, 253 U. S., 66,
 Green v. L. & N. Railroad, 244 U. S., 499,
 Atlantic & P. Tel. Co. v. Philadelphia, 190 U. S., 160,
 L. & N. Railroad v. Green, 244 U. S., 522,
 L. & N. Railroad v. Baswell, 290 Federal, 380.

When jurisdiction is properly attached it extends to the whole case and all issues involved, whether of Federal or

non-Federal character,

side upon all the questions and the Court has authority to de-

Louisville Trust tions involved.

Louisville & N. E. Company v. Stone, 107 Federal, 305,

Railroad v. Taylor, 86 Federal, 168.

Complainant Has

The Consolidated States No Adequate Remedy at Law.

7979 (see appendix), statutes of North Carolina, 1919, Section granted by any Court provide that an injunction shall not of taxes nor to restrain or judge to restrain the collection payment of taxes, except the sale of any property for the non- be levied or assessed for such tax or the part thereof enjoined or be illegal and invalid for an illegal or unauthorized purpose

In construing this aid, or the assessment illegal or invalid. Carolina, in Sherrod v. statute, the Supreme Court of North the opinion being by J. Dawson, 154 N. C. 525, at page 528,

Mr. Justice Brown says:—

“An injunction taxes and to restrain will lie to restrain the collection of traint, for three restrain the sale of property under dis- any part thereof reasons, to-wit: (1). If the taxes or thORIZED purpose. be assessed for an illegal or unau- invalid. (2). If the tax itself be illegal or (3). If the assessment of the tax be illegal or invalid. Revised Sections, 821 and 2855. Purnell v. Page, 133 N. C. 125. (Italics ours.)

“In the case of Lumber Company v. Smith, 146 N. C. 199, which was an action brought to collect taxes on solvent credits, Justice Connor, writing the opinion of the Court, for an undivided bench, held that an injunction is the proper remedy as against delinquent taxes illegally sought to be collected. Upon the same point see also Armstrong v. Stedman, 130 N. C. 217. Insurance Company v. Stedman, 130 N. C. 221.

“In this case the injunctive relief sought is not merely ancillary to the principal relief demanded in the action but itself a main relief, for assuredly as to one or the other counties, the tax is illegal and invalid.

"In the case of *Hyatt v. DeHart*, 140 N. C. 270, this Court held that it is the general rule that the Court will not dissolve an injunction where the main relief demanded in the action is injunctive.

"In *Purnell v. Page*, 133 N. C., 129, the present Chief Justice spoke for the Court in these words 'As to the other point, whether the plaintiff can maintain an injunction against the sale of his property under an illegal tax, or must pay the tax under protest and sue to recover it back, it is equally well settled that he can pursue either remedy.'

"*Range Company v. Carver*, 118 N. C. 331, *Armstrong v. Stedman*, 130 N. C. 217, and *Brinkley v. Smith*, 130 N. C. 224, hold that under the language of the statute injunctive relief may be invoked by a taxpayer when the tax is invalid or illegal."

It appears from the decision, therefore, of Judge Brown that the Supreme Court has construed this statute to mean that a taxpayer under the laws of North Carolina is given his choice of either an injunction to restrain the collection of an illegal tax, or pay the same under protest and sue to recover it back.

Submission to the injunction of this action, by an Act entitled, "An Act to Refund Taxes Illegally Collected and Paid into the State Treasury," Chapter 96 Public Laws, N. C., Extra Session 1921, page 122, ratified the 19th day of December, 1921, it was provided as follows:

"Section 1. Whenever taxes of any kind are or have been through clerical error, or misinterpretation of the law, or otherwise, collected and paid into the State Treasury in excess of the amount legally due the State, the State Auditor shall issue his warrant for the amount so illegally collected, to the person entitled thereto, upon certificate of the head of the department through which said taxes were collected or his successor in the performance of the functions of that department, with

the approval of the Attorney-General, and the Treasurer shall pay the same out of any funds in the treasury not otherwise appropriated: Provided, demand is made for correction of such error or errors within two years from the time of such payment: Provided further, that claims which have arisen within the five years next preceding the ratification of this act shall be presented and made within two years from the ratification of this act."

It is contended by the appellees that the appellant is, by the provisions of this Act afforded an adequate remedy at law for the payment of the taxes involved in this action.

The Act does not require the payment back, except upon the certificate of the head of the department through which the taxes were collected "with the approval of the Attorney-General." It may or may not be possible to secure the certificate of the head of the Department or the approval of the Attorney-General. The State has not consented to be sued and therefore no remedy at law is provided by the Statute.

The facts alleged in the bill as to the inadequacy of the plaintiff's remedy at law entitle it to the equity jurisdiction of the Federal Courts is clearly shown by the following decisions:

- Raymond v. Traction Co., 207 U. S., page 20;
- Cummings v. Merchants Ntl. Bank, 101 U. S. 153;
- Taylor v. Louisville & Nashville R. Co., decision by present Chief Justice Taft, 88 Fed. 350;
- Smith v. Ames, 169 U. S. 466;
- Greene v. L. & N. R. Co., 244 U. S. 499;
- L. & N. R. Co. v. Green, 244 U. S. 522;
- Borden's Condensed Milk Co. v. Baker, 177 Fed. 906;
- Wallace v. Hines, 253 U. S. 66;
- Atlantic & Pacific Tel. Co. v. Philadelphia, 190 U. S. 160;
- L. & N. R. Co. v. Boswell, 209 Federal, 380.

II

The income tax is invalid because it is not levied upon net income but is levied upon operating income of the plaintiff, which is gross income and which violates Article 5, Section 3 of the Constitution of North Carolina.

Article 5, Section 3 of the Constitution makes it mandatory upon the State to levy an ad valorem tax for State purposes and permits the Legislature to tax trades, professions, franchises and income, Provided the rate does not exceed six per cent (6%), and Provided the exemptions therein shown are allowed. This article after providing these exemptions, concludes in the following language "And there may be allowed other deductions (not including living expenses) so that only net incomes are taxed."

Complainant contends, and justly so we think, that this section of the Constitution limits the power of the Legislature to the enactment of laws which will tax net income only. The words "income" and "net income" have a definite and well understood meaning, and this every day meaning must be construed by this Court to be the one which the people intended should be used in the interpretation of this article of the Constitution at the time of the adoption of the amendment in 1920.

Had the people of the State of North Carolina, when this article was amended, intended to permit the Legislature to levy a tax upon gross income they would have said so in plain and definite terms. We say that the plain intent of the Constitution therefore is that only net income shall be taxed. Net income does not mean gross income, with such exceptions as the Legislature or Commissioner of Revenue shall see fit to make. It means what it says, that is, that it shall be net income, and not gross income. The Constitution must be construed according to its true meaning. It cannot be construed to be a thing which, in truth and in fact, it is not, and was never intended to be.

In the interpretation of a Constitution or Statute levying

taxes, it is an established rule not to extend the provisions by implication beyond the clear import of the language used or to enlarge the operation so as to embrace matters not specifically pointed out.

Gould v. Gould, 245 U. S., 151;

American Net & Twine Co. v Worthington, 141 U. S., 468;

Benziger v. United States, 192 U. S., 38;

In *Eisner v. Macomber*, 252 U. S., 189, this Court had against the government in favor of the citizen. *Idem*.

in *Eisner v. Macomber*, 252 U. S., 189, this Court had before it the construction of the income tax levied by Congress and therefore, of course, the construction and interpretation of the Sixteenth Amendment was necessary to be considered.

The Court says, page 206:

“A proper regard for its genesis, as well as its very clear language, requires also that this Amendment shall not be extended by loose construction, so to repeal or modify, except as applied to income those provisions of the Constitution that require an apportionment according to population for the direct taxes upon the property, real and personal. This limitation still has no appropriate and important function, *and is not to be overridden by Congress or disregarded by the Courts.* (Italics ours).

“In order, therefore, that the clause cited from Article 1 of the Constitution may have proper force and effect, save only as modified by the Amendment, and that the latter also may have proper effect, it becomes essential to distinguish between what is and what is not ‘income,’ as the term is there used; and to apply the distinction as cases arise, according to truth and substance, without regard to form. Congress cannot by any definition it may adopt conclude the matter, since it cannot by any legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised.

"The fundamental relation of 'capital' to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time. For the present purpose we require only a clear definition of the term 'income' as used in common speech, in order to determine its meaning in the Amendment; and, having formed also a correct judgment as to the nature of a stock dividend, we shall find it easy to decide the matter at issue."

The language used in a statute or constitution which has a settled and well known meaning sanctioned by judicial decision, is presumed to be used in that sense by the legislature or constitutional body.

Latimer v. United States, 223 U. S., 501;

Kepner v. United States, 135 U. S., 100;

Abbottsford, 98 U. S., 440.

The word "income" has been defined by the Court in *Stratton's Independence v Howbart*, 231 U. S., 399, 415, as follows:

"Income may be defined as the gain derived from capital, from labor, or from both combined."

Eisner v. Macomber, 252 U. S., 189, 207.

Miles v. Safe Deposit & Trust Co., decided May 29, 1922.

The word is defined in 26 Ruling Case Law, 149, as follows:

"The word income appears to have been used in the reported cases as meaning gross receipts, net earnings, gains or profits, depending on the context. In constitutional and statutory provisions in regard to taxation however, income appears to be uniformly construed as meaning net income, as opposed to gross receipts, which are also in some cases a measure of taxation. Income

means the balance of gain over loss and where there is no such balance of gain there is no income which is capable of being assessed. *The gross returns which an owner receives from his property do not denote his income, which means what he has for himself, what he can spend after satisfying all just outgoings in respect to the property which yield the return.*" (Italics ours).

There remains, therefore, to be considered, only the proper meaning the words "net income," as used in the constitution, and not as defined by the legislature.

The word "net" means free from charges or deductions obtained after deducting all expenses.

The words "net to us" in a telegram sent by plaintiff to defendant, offering to sell butter for 17c. "net to us" means that the price is to be 17c. free from all charges and deductions.

Floral Creamery v. Dillon (Conn.), 75 Atlantic, 82.

In *Fleet v. Hertz*, (Ill.), 66 N. E., 858, 861, the Court holds that where the furs were sold "net," this would mean that the seller was required to defray the cost of the delivery.

The Century Dictionary and Encyclopedia gives the following definition of the word "net":

"Clear of anything extraneous; with all deductions (such as are charges, expenses, discounts, commissions, taxes, etc.) made: as net profits, or net earnings; net proceeds; net weight." "Net profits, what remains, as the clear gain of any business adventure, after deducting the capital investment in the business, the expense incurred, in its management and the losses sustained by its operation."

Webster defines as follows:

"Free from extraneous substance; clear of, or free from, all charges, deductions, etc.; (a) remaining after deduction of all charges, outlay, loss, etc.; as net profit;

net proceeds; net income. (b) Clear of or excluding all tare, tret or the like; as net weight."

In *St. John v Erie Railway Company*, 89 U. S., 136, the Court considered the definition of the words "net earnings." The Court says:

"The preferred dividends were to be paid out of 'the net earnings of the road.' The lexical definition of net is 'clear of all charges and deductions.' Webster. 'That which remains after the deduction of all charges or outlay, as net profit.' Worcester. The popular acceptance of the term is the same."

In *Scott v. Harley*, 25 N. E., 826, 828, the Indiana Court defined "net" to be clear of all tare, tret, and other deductions taking the definition as used in the dictionaries.

The Illinois Court, in *Gibbs v. People's National Bank*, 64 N. E., 1060, defines the word "net" as:

"Clear of anything extraneous, with all deductions, such as charges, expenses, discounts, commissions, taxes, etc., made; free from expense" again taking the same definition as used in the dictionaries.

To the same effect is the definition given by the Texas Court in *Turnley v. Michael*, 15 S. W., 912.

The Maine Court, in *Andrews v. Boyd*, 5 Me., 199, defines the term "net" as a term used among merchants to designate the quantity, amount or volume of an article or commodity after all tare and charges are deducted.

In *Bromley v. Elliott* (N. H.), 75 Am. Dec., 182, the Court says:

"The term 'net income' cannot be understood to mean gross profits."

Applying the principle of construction laid down in *Eisner v. McCumber*, *supra*, to the Constitution of North Carolina, it is clear that the words "so that net incomes only are taxed" must be construed to mean that only that portion of the income

shall be taxed after deducting all charges, expenses, discounts, commissions, taxes, interest, etc. In other words, that the term "net" must be taken to mean, what it has always been defined to mean, "what remains of a business venture after the deductions of all charges and expenses incurred in the management." These words in the Constitution are a limitation upon the power of the Legislature to tax incomes and cannot be over-ridden, or disregarded, either by the Legislature or by the Courts, and the collection therefore, of any amount, due under the terms of this statute as income, should be enjoined as illegal and in contravention of the Constitution.

The General Assembly of 1921, in recognition of the limitation which the Constitution has imposed upon it in passing an income tax law, declared the general purpose of the act to be to impose a tax upon the net income. Section 101 provide, "The general purpose of this act is to impose a tax for the use of State Government upon the net income, etc."

Under the provisions of the Act of Congress the Interstate Commerce Commission has adopted a uniform system of accounting known as the "Standard Classification of Accounts," a copy of which has been filed in this case. This classification of accounts is made in order to arrive at what is gross income, operating revenue and net income. In order to arrive at the true net income, therefore, of a railroad corporation, doing an interstate business, and keeping its accounts in accordance with this classification of accounts, the following deductions must be made:

- Joint Facility Rents;
- Rent for Leased Roads;
- Miscellaneous Tax Accruals;
- Separately Operated Properties—Loss;
- Interest on Funded Debt;
- Interest on Unfunded Debt;
- Amortization of Discount on Funded Debt;
- Maintenance of Investment Organization;
- Income Transferred to other Companies;

Miscellaneous Income Charges,

and possibly one or two other deductions.

The North Carolina statute provides for a tax to be paid upon operating revenue after deducting uncollectible revenue and taxes paid within the State for the income year, and car hire. The statute therefore does not fix a tax on net income but a tax upon what it calls "net railway operating income." There is no such term as "net railway operating income" in the standard classification of accounts of the Interstate Commerce Commission, but if the term "net railway operating income" is to be construed as that income defined as such in Section 1 of the Federal Control Act, in Section 15-A of the Interstate Commerce Act and Section 209 of the Transportation Act of 1920, then this complainant is entitled in addition to the deductions allowed by the North Carolina Statute, the following deductions:

- Locomotive hire;
- Work Equipment hire;
- Floating Equipment hire;
- Joint Facility Rents

all of which are set forth in the said classification of accounts.

The result of this statute, and of the interpretation of the statute by the Commissioner of Revenue as set forth in the forms which he requires interstate railroad corporations to fill out and send for the purpose of assessing taxes against them, is that the machinery provided by the North Carolina Statute for the ascertainment of net income does not in truth and in fact produce net income, although Section 101 of the statute declares it to be the purpose of the act to tax "net income." Notwithstanding this declared purpose of the act the method outlined under the law for arriving at net income does not produce net income but produces a figure which is gross income with three deductions.

Manifestly therefore, accepting the definitions of net income set forth above, such deductions must be permitted before it can be determined what the railroad company has

left over for itself and what it can spend after satisfying all of its just expenses in respect of the property which yields revenue. Revenue and net income are distinct and separate accounts. Revenue cannot be converted into net income until items of expenses which have produced the revenue have been deducted.

Writers on Economics all distinguish between capital and income and the definitions given by them are pertinent in respect to what is a proper definition of the words "net income."

In *The Federal Income Tax*, Edited by Robert Murray Haig, Columbia University Press, 1921, 27, is found the following:

"Income is the money value of the net accretion of economic power between two points of time. This definition cannot be written into a statute in literal form because of the technical disadvantages in determining income as so defined, but so long as taxable income differs appreciably from this definition there will be anomalies and injustices in income taxation and other steps marking a closer approximation of this definition will result in the elimination of irregular and eccentric results."

In a book entitled "*The American Law Relating to Income and Principal*," the writer in his introduction says:

"The necessity of distinguishing carefully between income and principal is imposed chiefly upon trustees, and with them it is a matter of great importance; but the same necessity is imposed upon life tenants who have the possession and control of the property, and the same general principles apply to both."

This same writer further says:

"In determining whether dividends on shares of stock in corporations or joint stock companies are income or are wholly or part corpus the same general principles of preserving the corpus intact and not using it up as income applies in other investments. If dividends are not

paid out of earnings, but are really divisions of the capital of the corporation or company, they constitute part of the principal of the trust, and should be treated as income in the absence of a contrary intention of the creator of the trust."

An income tax is not a tax upon capital. It is a tax solely upon gains and profits.

Seligman in his work on income tax, revised edition, 19 says:

"Income is that which comes in to an individual above all necessary expenses of acquisition, and which is available for his own consumption. Income as contrasted with capital denotes that amount of wealth which flows in during a definite period and which is at the disposal of the owner for purposes of consumption so that in consuming it his capital remains unimpaired.

"Income is of course to be distinguished from mere receipts or gross revenues, it is more than that which simply comes in from any economic activity. *By income is always meant net income, as opposed to gross income.*" (Italics ours) "In other words, from the receipts in any enterprise we must in the first place, deduct the expenses of the enterprise—that is, the outlay incurred in securing the gross product. But secondly, income as a personal category differs from net profits. If a debt has been contracted in order to secure the product of a given piece of property or of a given enterprise, the interest on the debt must be deducted. Finally, in the outlays or expenses which have been incurred to secure the product, there must also be included a compensation for wear and tear of plant; just as the investor in securities computes his actual income by deducting an amortization quota from the annual proceeds. *Income, therefore, always means net income.* (Italics ours).

The Public Service Commission of New York, page 213, Reports of 1908, defines net income as follows:

"10. Gross Income, Income Deductions, and Net Corporate Income defined.

Revenues, diminished by expenses, taxes and uncollectible bills give an amount called GROSS INCOME, which is applicable to corporate and leased properties. Gross Income is subject to several compulsory deductions, mostly contractual, like rent, interest, etc., and the remainder after these are made is called NET CORPORATE INCOME, which being subject only to the discretion of the corporation is most conveniently carried directly to the concrete surplus. The accounts covering the compulsory deductions from gross income, as above defined, are called the INCOME DEDUCTION accounts."

The Interstate Commerce Commission in its order of May 19, 1914, defines Income Accounts, as follows:

"Income accounts are those designed to show, as nearly as practicable, for each fiscal period, the total amount of money that a carrier becomes entitled to receive for services rendered the returns accrued upon investments, the accrued costs paid or payable for the service rendered by it, the loss sustained by it, the amount accrued for taxes, for the use of moneys and for the use of properties of others, and the appropriations made from income during the period. The net balance of income (or loss) shall be carried to Profit and Loss."

In the same order it prescribes a form of Income Statement for common carriers, in which the outstanding items are:

- I. Operating Income.
 - II. Non-operating Income.
- (The total of these two is designated as "Gross Income.")
- II. Deductions from Gross Income.

Among the deductions are:

- "Rent for leased roads."
- "Miscellaneous Rent."

"Interest on Funded Debt."

"Interest on Unfunded Debt, etc."

The total of these deductions from Gross Income leaves a balance, termed by the Commission "Net Income."

Railroads are financed by the issuance of stock, and also by the sale of bonds. It is simply a question of how the money can be secured to the best advantage. It is true that the proceeds from the sale of bonds are used in the purchase of capital assets, described in the Commission's classification under the head of—"Investment in Road Equipment." It is equally true that the interest on such bonds is not charged to Capital Account, but is included as a deduction from Gross Income, as part of the expense of conducting the business. It is just as truly a deduction from Gross Income as are rents, and other expenses incidental to the conduct of the business.

The Commission, in its rules, specifically prohibits a road in operation from charging to its Capital Account the interest on bonds or other funded indebtedness.

The defendants in the argument below relied greatly upon the affidavit of Mr. Maxwell, a member of the North Carolina State Tax Commission (Record pages 54, 57, 58 and 59) His testimony for the State in reference to the rent for leased lines, etc., was as follows:

"With reference to the matters of rentals paid for the lines leased and operated by railroads, the committees considered the well known facts that these leases are usually for the long terms and with numerous collateral obligations which make them amount practically to purchases of the lessor road's property by the lessee, and that, this being true, the consideration paid for such long leases of property used fully as if the property of the lessee in its business is really not an operating expense but is by clear analogy and in practical effect a capital expense. If these expenses were allowed as deductions to the plaintiffs, the results would be that they would have no income subject to tax until they had earned enough to provide, not only for all business and operating

expenses, but also for all capital expenses and had paid all interest on their bonds; in other words, it would amount to nothing more than a tax on the savings of railroads, which would render the tax utterly incommensurate with that imposed on individuals and other ordinary corporations."

Mr. Maxwell is, therefore mistaken in his statement that interest thus deducted would be equivalent to providing the capital expense out of Operating Income. Mr. Maxwell is also, incorrect in his assumption in the matter of rentals paid for leased lines. Such rentals are usually based upon the value of the property and no matter what the length of the lease may be, a railroad, in paying such rental, acquires no equity in the property, and is under obligation to return the property at the end of the lease in as good condition as when received. The rental paid for such lease lines is, therefore, a proper deduction from Gross Income to the same extent and in the same manner as is the rental paid by an individual for the house in which he lives, and in which he acquires no equity whatever by the payment of such rental.

Mr. Maxwell further states that under the railroads' convention they would provide for all capital expenses before arriving at Net Income. As a matter of fact, the Accounting Classification of the Interstate Commerce Commission do not permit the charge to Income of any items representing capital expenditure. It has been in effect for many years, and is

This accounting has been in effect for many years, and is well understood by governmental regulating bodies as well as by all officers employed in the operation of railroads.

III.

because it allows Intrastate Railroads

The Act is invalid if it does Interstate Railroads and disallows greater deductions than it does for Intrastate Railroads doing business both within and without the State and thus violates the Constitution of the United States and the

(a)

There are five different classes of corporations attempted to be classified by the income tax act of 1921, under Section 201 to 204, inclusive, and 300 to 306, inclusive as follows:

(1) Corporations engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business or other form of public service *when such companies are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission and whose business is in part within and in part without the state* are required to pay a tax equal to 3 per cent of their gross operating revenues within the state, including therein the equal mileage proportion within this state of their interstate business and deducting therefrom the proportionate average of the operating expenses or operating ratio for their whole business as shown by the Interstate Commerce Commission standard classification of accounts, and from the amount thus ascertained is deducted uncollectible revenue and taxes paid in the state other than income tax and war profits and excess profit taxes and there is also deducted any debit balance paid on account of car hire.

(2) Corporations engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service *when such companies are required to keep records according to the standard classification of accounting of the Interstate Commerce Commission and whose business is wholly within the state* are required to pay a tax equal to 3 per cent of their "net operating income" as shown by their records kept in accordance with the standard classification of accounts with the deductions above set forth.

(3) Corporations engaged in the business of operating a steam or electric railroad, express service, telephone or telegraph business, or other form of public service, *when such companies are not required to keep records according to the standard classification of accounting of the Interstate Com-*

merce Commission are required to pay a tax of 3 per cent on net income similar to that imposed upon all other corporations by section 201 of the Income Tax Act and such corporations are allowed deductions from their gross income set out in section 306 of the said act, which deductions are not allowed corporations referred to in (1) and (2) above.

(4) Corporations which own a steam or electric railroad, express service, telephone or telegraph business, or other form of public service and which are not engaged in the operation thereof, but have an income from other sources, such as leases, rentals, etc., are allowed the same deductions as other corporations and pay the tax only on net income.

(5) Every corporation organized under the laws of North Carolina and every foreign corporation doing business in the state, except the corporations referred to in paragraphs (1) and (2) are required to pay a tax equivalent to 3 per cent of their net income and in arriving at net income such corporations are allowed the deductions set out in section 306 of the **Income Tax Act**.

The provisions of section 202 are restricted to corporations engaged in interstate commerce because by the terms of the interstate commerce act only such corporations are required to keep their accounts according to the standard classification of the accounting of the Interstate Commerce Commission. (Act to Regulate Commerce Feb. 4th, 1887, c. 104, sec. 20, 24 Stat. 386 as amended; Barnes' Federal Code, 1921 Supplement, Sec. 7916.)

The affidavits of M. S. Hawkins (Record Page 35), and H. E. Kemper (Record page 39), filed in behalf of the plaintiff herein, show that railroads like the Atlantic & North Carolina, which is leased to the Norfolk Southern, the North Carolina Railroad, which is leased to the Southern Railway, the Durham and South Carolina leased to the Norfolk Southern Railway, and other like corporations in the State of North Carolina, are not taxed on their income "because they are

not engaged in the business of operating a steam or electric railroad, etc.”

These same leased railroads however produce revenue for their stockholders and lessors. The State of North Carolina is a stockholder in some of them, but there are individual stockholders also.

This produces a plain and arbitrary discrimination against the plaintiff. A corporation owning a railroad which it leases to another railroad, although it receives an honest income from that and other sources, is not liable for an income tax imposed upon corporations “engaged in business.”

McCoach v. Minehill and S. H. R. Co., 228 U. S., 295, 303, 304.

The Court in that case says:

“From the facts stated above it is entirely clear that and 1910 engaged at all in the business of maintaining the Minehill Company was not, during the years of 1909 or operating a railroad, which was the prime object of incorporation. This business, by the lease of 1896 it had turned over to the Reading Company . . . And it is the Reading Company, and not the Minehill Company, that is doing business as a railroad company upon the lines covered by the lease.”

The classification under this statute is arbitrary and unreasonable, and is invalid under the case of *Royster Guano Co. v. Virginia*, 253 U. S., 412. In that case the court held that the act of Virginia of 1916, in so far as it imposed on a domestic corporation doing business both within and without the State, a tax with respect to its income derived from sources outside the State denied such a corporation the equal protection of the laws in violation of the Fourteenth Amendment in view of another Act of Virginia, which exempted domestic corporations doing no part of their business within the state from any tax on their income. The Court also held

that classification for the purpose of legislation must be reasonable and not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislature so that all persons similarly circumstanced shall be treated alike.

In *Southern Railway Company v. Green*, 216 U. S., 400, the Court says:

"While reasonable classification is permitted without doing violence to the equal protection of the laws, such classification must be based upon some real and substantial distinction, bearing a reasonable and just relation to the things in respect to which such classification is imposed; the classification cannot be arbitrarily made without any substantial basis. Arbitrary selection, it has been said, cannot be justified by calling it classification. *Gulf C. & F. R. Co. v. Ellis*, 165 U. S., 150; *Cotting v. Kansas City Stock Yards Co.*, (*Cotting v. Godard*), 183 U. S., 79; *Conolly v. Union v. Sewer Pipe Co.*, 184 U. S., 540.

"It is averred in the complaint and must be taken as admitted, that there are other corporations of a domestic character in Alabama, carrying on the railroad business in precisely the same way as the plaintiff. It would be a fanciful distinction to say that there is any real difference in the burden imposed because the one is taxed for the privilege of a foreign corporation to do business in the state, and the other for the right to be a corporation. The fact is that both corporations do the same business in character and kind, and under the statute in question a foreign corporation may be taxed many thousands of dollars for the privilege of doing, within the state, exactly the same business as the domestic corporation is permitted to do by a tax upon its privilege, amounting to only a few hundred dollars.

"We hold, therefore, that to tax the foreign corporation for carrying on business under the circumstances

shown, by a different and much more onerous rule than is used in taxing domestic corporations for the same privilege, is a denial of the equal protection of the laws, and the plaintiff being in position to invoke the protection of the Fourteenth Amendment that such attempted taxation under a statute of the state does violence to the Federal Constitution."

In *G. C. & S. F. R. Co., v. Ellis*, 165 U. S., 150, which is probably the leading case upon discrimination by arbitrary classification, the Court says:

"It is apparent that the mere fact of classification is not sufficient to relieve a statute from the reach of the equality clause of the Fourteenth Amendment, and that in all cases it must appear not only that a classification has been made, but also that it is one based upon some reasonable ground, some difference which bears a proper relation to the attempted classification, and is not a mere arbitrary selection."

Bell's Gap R. Co. v. Pennsylvania, 134 U. S., 232.

Magoun v. Bank, 170 U. S. 283.

Keeny v. New York, 222 U. S., 525.

In *Southern Railway v. Greene*, 216 U. S., 400, the Court says:

"Arbitrary selection cannot be justified by calling it classification."

In the case of *Cotting v. Godard*, 183 U. S., 79, the Court said:

"But while recognizing to the full extent the impossibility of an imposition of duties and obligations mathematically equal upon all, and also recognizing the right of classification of industries and corporations, we must nevertheless, always remember that the equal protection of the laws is guaranteed, and that such equal protection is denied when upon one of two parties engaged in the

same kind of business and under the same conditions burdens are cast which are not cast upon the other."

It is very apparent that burdens are cast upon plaintiff in this case which are not cast upon intrastate railroads in North Carolina which do not keep their accounts in accordance with the standard classification of accounting fixed by the Interstate Commerce Commission.

In the case of *Truax v. Corrigan*, 257 U. S. 312, this Court had before it the application of the equal protection clause of the Constitution, and specifically passed upon the question of arbitrary selection and classification. This opinion was by Mr. Chief Justice Taft, from which we quote the following language:

"In *Hayes v. Missouri*, 120 U. S., 68, 30 L. ed., 578, 7 Sup. Ct. Rep., 350, the Court, speaking through the same justice, said the Fourteenth Amendment 'does not prohibit legislation which is limited either in the objects to which it is directed or by the territory within which it is to operate. It merely requires that all persons subjected to such legislation shall be treated alike, under like circumstances and conditions, both in the privileges conferred and in the liabilities imposed.' Thus, the guaranty was intended to secure equality of protection not only for all, but against all similarly situated. Indeed, protection is not protection unless it does so. Immunity granted to a class, however limited, having the effect to deprive another class, however limited, of a personal or property right, is just as clearly a denial of equal protection of the laws to the latter class as if the immunity were in favor of, or the deprivation of right permitted worked against, a larger class."

(b)

This discrimination violates the uniformity clause of the Constitution of North Carolina and under the following decisions of the Supreme Court of North Carolina is invalid:

State v. Williams, 158 N. C., 610.

State v. Moore, 113 N. C., 698.

Pruitt v. Commissioners, 99 N. C., 709.

Worth v. Railroad, 89 N. C., 291.

Redmond v. Town of Tarboro (N. C.), 10 S. E., 845.

In the last case the Court said, after quoting from numerous cases:

"These cases decide that, when the taxing power is exercised for a public purpose, *the Constitution, and not the Legislature*, declare what property shall be taxed, and by a uniform rule, and *ad valorem*."

In *Mercantile Company v. Mount Olive*, 161 N. C., 125, 76 S. E., 691, it is said:

"In *Lacy v. Packing Co.*, 134 N. C., 572 (47 S. E., 53), the above authority and others were cited, the court thus summing up the law: 'It is settled that a license tax is uniform when it is equal upon all persons belonging to the described class upon which it is imposed.' It is pointed out that the constitutional provision requiring uniformity applies only to property, but, as to license taxes, it quotes with approval the following from *State v. Stephenson*, 109 N. C., 734 (14 S. E., 387), 26 Am. St., 595: 'It is within the legislative power to define the different classes and to fix the license tax required of each class. All he can demand is that he shall not be taxed at a different rate from others in the same occupation, as classified by legislative enactment. This is stated as a universal rule. 1 *Cooley on Taxation* (3d Ed.), 260.' "

In the case of *Worth v. Railroad*, 89 N. C., 291, the tax law under consideration provided for the taxation of three classes of railroads, and the taxes imposed upon one were not imposed upon the other two. The three classes of railroads are described in the opinion at page 294, as follows:

"1. If the road is, by virtue of the contract contained in its charter, exempt from taxation upon its property or

shares, a tax is levied upon the incorporation equal in amount to one per centum upon its gross receipts.

2. If it be exempt from liability to taxation upon its real estate held 'for right of way, for station places and workshop locations,' following the language of the exemption contained in the charter of the North Carolina railroad company, as amended in the act of February 14th, 1855, but is liable to a tax upon its franchise and personal estate, it is subjected to a tax of one per centum upon the gross receipts.

3. If the property of the road be exempt, and it be not liable to the preceding tax, it was before subjected to a tax of one per cent upon the cash value of the shares, and by the act of 1881 instead, to what is termed a privilege tax of twenty-five dollars per annum for each mile of its track through its entire extent."

In holding that this method of the taxation of railroads violates the Constitution of North Carolina, Chief Justice Smith says :

"The first enumerated tax is not general in its application to railroads and canals, but is special and confined to such only as fall within the descriptive words of the statute, and the same is strictly true as to the others. The obvious result of this legislation is to impose burdens on exempted roads, which are not imposed upon those unexempted, and pro tanto to counteract the effect of the discriminating privileges and immunities that would otherwise subsist between them.

If the same general burdens were put upon all alike, whatever might be the subject matter of the taxation, the favored roads would continue to possess and enjoy the privileges conferred in their charter, and not found in the charters of the others. Indirectly, then, the legislation tends to withdraw the immunities secured by their charters, and constituting a contract between the State and themselves, or lessen their value, so that all may proxi-

mately, at least, stand upon the same footing, as if none such had been conferred.

We should be reluctant to hold, if there were no question of constitutional right involved, that this method of levying taxes was sanctioned by our own constitution, and consistent with the equality and uniformity which it contemplates.

The 'uniform rule' to be observed in the exercise of the taxing power seems to be so far applicable to the taxes imposed on 'trades, professions, franchises and incomes,' as to require that no discriminating tax be imposed upon persons pursuing the same vocation, while varying amounts may be assessed upon vocations or employments of different kinds.

'Although it is not expressly provided that the tax on trades, etc., shall be uniform,' in the words of Rodman, J., delivering the opinion of *Gatlin v. Tarboro*, 78 N. C., 139, 'yet a tax not uniform, as properly understood, would be so inconsistent with natural justice, and with the intent which is apparent in the section of the constitution above cited (Art. 5, Sec. 3) that it may be admitted that the collection of such a tax would be restrained as unconstitutional.' This uniformity prescribed in the Constitution of Illinois, as declared by Mr. Justice Miller, extends 'to the class upon which the law shall operate; that is inn-keepers may be taxed by one, ferries by another, railroads by another (rule); provided, that the rule as to inn-keepers be uniform as to all inn-keepers; the rule as to ferries be uniform as to all ferries, and the rule as to railroad companies be uniform as to all railroad companies.' *Railroad Tax Cases*, 92 U. S., 575. The governing principle is not that the same specific tax shall be paid by each, as a form of capitation tax, but that, whether levied upon and measured by the amount of gross or net earnings or other standard, as upon real or personal estate, there shall be no discrimination made among the

individuals of a class, based upon privileges and immunities secured to one under contract and not to another. The essential element in all systems of taxation is equality in imposing burdens upon the property of the taxpayers, so that each one, possessing the same species of property, shall pay the same proportionate tax as every other levied upon that property, and in this State such tax is required to be ad valorem."

Under these authorities therefore we say that the Act is invalid because it is discriminating against this complainant and in favor of other corporations, and because the tax is not uniform.

In *State v. Willams*, supra, the Court held that in paying a tax the different subjects thereof must be reasonable, though not arbitrarily classified and a different rule of taxation prescribed for each class provided the rule is uniform in its application to the class for which it is made, and the result must be to prevent discrimination among individuals or subjects of any one class, based upon special privileges, immunities or exemptions allowed to one and not allowed to the other.

It is apparent from the authorities cited that the Income Tax Act is invalid, in that while all of the railroad companies doing business in the State are entitled to be placed in one class with reference to taxation, there is a clear discrimination against interstate railroads, in favor of intrastate railroads because intrastate railroads are allowed different and greater deductions than allowed to interstate railroads which imposes upon the latter a different and higher rate of taxation than upon the former.

The affidavit of J. H. Bridgers (Record, pages 33, 34), shows that he is President of the Henderson Water Company, which is a public service corporation, and that this corporation does not keep its accounts in accordance with standard classification of accounting of the Interstate Commerce Commission, and that under his accounting his corporation was not liable to income tax in North Carolina for the year 1921, but if his

accounts had been kept in accordance with the classification of accounting of the Interstate Commerce Commission he would have had to pay in accordance with the standard and this arises only from the fact that the Interstate Commerce Commission keeps its accounts in accordance with the standard classification of the Interstate Commerce Commission. Therefore, it does not have to pay the taxes which keep their accounts in accordance with that classification.

IV.

THE INCOME TAX ACT IS VOID BECAUSE IT IS A TAX AND BURDEN UPON INTERSTATE COMMERCE AND VIOLATES THE COMMERCE CLAUSE OF THE CONSTITUTION OF THE UNITED STATES.

The State of North Carolina taxes the entire property of the plaintiff, real, personal and intangible, as a going concern at full value, and this value is found by the Commissioner of Revenue, and was formerly found by the State Tax Commission. It is found by the assessment of the entire property of the railroad under Section 64 of the Machinery Act of 1921, Public Laws, 1921, page 265, which reads as follows:

"(a) At such dates as real estate is required to be assessed for taxation, the said commission shall first determine the value of the tangible property of each division or branch of such railroad of rolling stock and all other physical or tangible property. This value shall be determined by a due consideration of the actual cost of replacing the property, with a just allowance for depreciation on rolling stock, and also of other conditions, to be considered as in the case of private property.

"(b) They shall then assess the value of the franchise.

which shall be determined by due consideration of the gross earnings as compared with the operating expenses, and particularly by consideration of the value placed upon the whole property by the public (the value of the physical property being deducted), as evidenced by the market value of all capital stock, certificates of indebtedness, bonds, or any other securities, the value of which is based upon the earning capacity of the property.

“(c) The aggregate value of the physical or tangible property and the franchise as thus determined, shall be the true value of the property for the purpose of an ad valorem taxation, and shall be apportioned in the same proportion that the length of such road in each county bears to the entire length of such division or branch thereof; and the State Tax Commission shall certify, on or before the first day of September, to the chairman of the county commissioners and the mayor of each city or incorporated town the amount apportioned to his county, city, or town; all taxes due the State from any railroad company shall be paid by the treasurer of each company directly to the State Treasurer within thirty days after the first day of July of each year; and upon failure to pay the State Treasurer as aforesaid, he shall institute an action to enforce the same in the County of Wake or any other county in which such railroad is located, adding thereto twenty-five per centum of the tax. The board of county commissioners of each county through which said railroad passes shall assess against the same only the tax imposed for county, township, or other taxing district purposes, the same as levied on other property in such county, township, or special taxing districts.”

Upon the assessment made under this Act the railroad pays what is known as ad valorem taxes to the counties, cities and towns, and special taxing districts. Then by Section 82 (61½) of the Revenue Act of 1921, being Chapter 34, Public Laws, 1921, there is assessed upon this entire valuation of the rail-

road a tax of one-tenth of one per cent for State purposes. This section is as follows:

Sec. 82 ($6\frac{1}{2}$). Railroads. Every railroad company doing business in this State shall annually on or before the thirtieth day of July make and return to the State Tax Commission, in such form and upon such blanks as shall be furnished by the State Tax Commission, and giving such information as the State Tax Commission shall require, for the purpose of carrying out the provisions of this section, and upon which report the State Tax Commission shall ascertain and certify to the State Auditor the value upon which the amount of taxes which shall be paid by any such railroad company as a franchise or privilege tax shall be calculated. The basis upon which such calculation shall be made by the State Tax Commission and the extent to which every such railroad company is exercising its franchise in this State shall be found to be the value of the property, tangible and intangible, of each such railroad company in the State assessed for the year in which such report is made for ad valorem taxes. The franchise tax of each such railroad company for the privilege of exercising its franchise in this State shall be one-tenth of one per cent (0.1%) of the value so ascertained by the State Tax Commission, and such tax shall be due and payable on or before the fifteenth day of October in each year. If any such company shall fail to make the report provided for, it shall be the duty of the State Tax Commission to make an approximation from the reports and records on file in that department of the amount of taxes due under this section, and certify same to the State Auditor and Treasurer for collection. No county, city or town shall be allowed to collect any taxes under this section.

This Court in an opinion handed down on the 2d day January, 1923, decided that the ad valorem and so-called State franchise tax acts, quoted above, and the assessments levied

plaintiff, and the other railroads in North
 thereon, against this pl
 Carolina, were valid. y, et al. v. Watts, United States Su-
 Southern Railw Advance Opinions, February 1, 1923,
 preme Court
 page 199. that by these two acts the plaintiff

Thus it will be seen railroad property at full value taken
 is already taxed on it and this income tax is nothing more
 as a going concern, in the gross receipts disguised by the
 than an effort to reac
 name of an income tax. It is shown it is apparent that this tax is

From the facts already shown it is apparent that this tax is
 not a tax upon net income but is a tax upon gross income. Be-
 not a tax upon net income which in itself is derived partly
 ing a tax upon gross income and partly from interstate com-
 from intrastate commerce because it attempts to tax such part of
 merce, the act is void of the complainant which it derived
 the operating revenue, as is represented by the propor-
 from interstate commerce of the complainant's entire system, ex-
 tion of the mileage of the complainant's entire system, ex-
 mileage of railroad of the complainant's entire system, ex-
 tending into many states. The amount of the tax therefore is
 largely dependent upon the volume of interstate commerce
 done by this complainant, and therefore amounts to a direct
 commerce.

burden upon interstate commerce almost identically the same as the tax
 The tax in this case is almost identically the same as the tax
 condemned by this Court in Galveston, Harrisburg, etc.,
 R. R. v. Texas, 210 U. S. 217. That case involved the validity
 of a Texas statute imposing a tax upon railroads and other
 corporations owning or controlling any line of railroad within
 that State, equal to one-tenth of one per cent (and repealing
 the existing tax law), on gross passenger earnings of rail-
 roads. Section 1 of the statute imposes—

“an annual tax for the year 1905 and for each calendar
 year thereafter equal to one per centum of its gross re-
 cepts, if such line of railroad lies wholly within the
 State,”

and Section 2 requires a report under oath of—

“the gross receipts of such line of railroad from every source whatever, for the year ending on the 30th day of June last preceding, and immediate payment of the tax, calculated on the gross receipts so reported.”

The lines of railroad of the plaintiff lay wholly within the State of Texas but they connected with other lines and a part, and in some instances the larger part, of the gross receipts was derived from the carriage of passengers and freight in interstate commerce. In the opinion of the Court Mr. Justice Holmes referred to the prior cases, including the case of *Maine v. Grand Trunk*, *Philadelphia & Southern Mail Steamship Company v. Pennsylvania*, *Adams Express Company v. Ohio*, *Pullman Company v. Pennsylvania*, and the other cases of like nature involving the construction of taxes upon railroads and public service corporations, and in commenting upon the case of *Maine v. Grand Trunk Railroad*, he says:

“In *Maine v. Grand Trunk R. R. Co.*, supra, ‘an annual excise tax for the privilege of exercising its franchise’ was levied upon every one operating a railroad in the State, fixed by percentages, varying up to a certain limit, upon the average gross receipts per mile multiplied by the number of miles within the State, when the road extended outside. This seems at first sight like a reaction from the *Philadelphia & Southern Mail Steamship Company* case. But it may not have been. The estimated gross receipts per mile may be said to have been made a measure of the value of the property per mile. That the effort of the State was to reach that value, and not to fasten on the receipts from transportation as such, was shown by the fact that the scheme of the statute was to establish a system. The buildings of the railroad and its land and fixtures outside of its right of way were to be taxed locally, as other property was taxed, and this excise with the local tax were to be in lien of all taxes. *The language*

shows that the local tax was not expected to include the additional value gained by the property being part of a going concern. That idea came in later. The excise was an attempt to reach that additional value. The two taxes together fairly may be called a commutation tax."

Further he says:

"By whatever name the exaction may be called, if it amounts to no more than the ordinary tax upon the property or a just equivalent therefor, ascertained by reference thereto, it is not open to attack as inconsistent with the constitution . . . The question is whether this is such a tax. It appears sufficiently, perhaps from what has been said, that we are to look for a practical rather than a logical or philosophical distinction. The State must be allowed to tax the property, and to tax it at its actual value as a going concern. On the other hand, the State cannot tax the interstate business. The two necessities hardly admit of an absolutely logical reconciliation. Yet the distinction is not without sense. When a legislature is trying simply to value property, it is less likely to attempt or to effect injurious regulation than when it is aiming directly at the receipts from interstate commerce. *A practical line can be drawn by taking the whole scheme of taxation into account. That must be done by this Court as best it can. Neither the State Courts nor legislature, by giving a tax a particular name or by the use of some form of words can take away our duty to consider its nature and effect.* If it bears upon commerce among the states so directly as to amount to a regulation in a relatively immediate way, it will not be saved by name or form. *Stockard v. Morgan*, 185 U. S., 27, 37, 46 L. Ed., 785, 794, 22 Sup. Ct. Reps., 576; *Asbel v. Kansas*, 209 U. S., 251, 254, 256, ante, 778, 780, 781, 23 Sup. Ct. Rep., 485.

"We are of the opinion that the statute levying this tax does amount to an attempt to regulate commerce

among the states. The distinction between a tax 'equal to' one per cent of gross receipts, and a tax of one per cent of the same, seems to us nothing except where the former phrase is the index of an actual attempt to reach the property and to let the interstate traffic and the receipts from it alone. We find no such attempt or any thing to qualify the plain inference from the statute, taken by itself. *On the contrary we rather infer from the judgment of the State Court and from the judgment on behalf of the State that another tax on the property of the railroad is upon a valuation of that property taken as a going concern. This is merely an effort to reach the gross receipts not even disguised by the name of an occupation tax and in no way helped by the words 'equal to.'*"

The following propositions are laid down in this case:

1. The State may tax the property of an interstate corporation and tax it at its actual value as a going concern.
 2. But it cannot tax the interstate business.
 3. That in determining whether the tax is void the whole scheme of taxation must be taken into account.
 4. That neither the State Court nor the legislature, by giving a tax a particular name or by use of some form of words, can take away the duty of the Court to consider its nature and effect.
 5. That if it bears upon commerce between the states so directly as to amount to a regulation in a relatively immediate way it will not be saved by name or form.
 6. That the Court, in deciding the case of *Maine v. Grand Trunk Railway*, decided, in upholding the statute in that case, that the estimated gross receipts per mile were the measure of the value of the property, and that the effort of the State was to reach that value, and not fasten on the receipts from transportation in the State and that this was shown in the scheme of the statute to establish assessment.
- In the case at bar we have shown that the State has already taxed plaintiff's property at its actual value as a going con-

cern; that in taxing the operating revenue of the plaintiff it not only attempts to but actually does tax the interstate business of the plaintiff, and the tax, therefore, bears directly upon interstate commerce and amounts to a regulation of it as stated in the above case.

This tax is void as being a regulation of interstate commerce and is in direct conflict with the decisions of the Supreme Court in the following cases:

- State Franchise Tax Case, 15 Wallace, 232.
- State Tax on Railroad Gross Receipts, 15 Wallace, 234.
- Fargo v. Michigan, 121 U. S., 230.
- Philadelphia & M. S. Co. v. Pennsylvania, 122 U. S., 326.
- Leloup v. Port of Mobile, 127 U. S., 640.
- Western Union Telegraph Company v. Alabama, 132 U. S., 472.
- Fargo v. Hart, 193 U. S., 490.
- Western Union Telegraph Company v. Kansas, 216 U. S., 1.
- Pullman Company v. Kansas, 216 U. S., 56.
- Ludwig v. Western Union Telegraph Company, 216 U. S., 146.
- Flint v. Stone Tracy Company, 220 U. S., 107.
- Meyer, Auditor of State of Oklahoma, v. Wells Fargo Co., 223 U. S., 298.
- Choctaw, Oklahoma & Gulf Ry. Co. v. Harrison, 235 U. S., 292.
- Looney v. Crane, 245 U. S., 178.
- International Paper Company v. Massachusetts, 246 U. S., 145.
- Wallace v. Hines, 253 U. S., 66.
- Royster v. Virginia, 253 U. S., 412.
- Davis, Director General, v. Wallace, decided January 9th, 1922.
- Gillespie v. Oklahoma, decided January 20th, 1922.

In Crew Levick Company v. Pennsylvania, 245 U. S., at

page 294 the Court calls attention to the fact that while it accepts the decision of the State Court of last resort respecting the proper construction of state statutes, it is in duty bound to determine the question raised under the Federal Constitution upon its own judgment *of the actual operation and effect of any tax irrespective of the form it bears or how it is characterized by the State Court.* This case involved a tax upon the business of vending merchandise graduated according to the gross annual volume of business transacted and it was shown that the plaintiff in error was engaged in foreign commerce and the receipts were from that source. The tax was held void for that reason.

In *William E. Peck v. Lowe*, 247 U. S., 165, the Court had under consideration the Income Tax Act of the United States which was attacked upon the ground that it was a tax upon exports from one state to another. The Act was held valid, but the ground upon which it was held valid should not be lost sight of. We quote from the decision as follows:

"The tax in question is unlike any of those heretofore condemned. It is not laid on articles in course of exportation, or on anything which inherently or by the usages of commerce is embraced in exportation or any of its processes. On the contrary it is an income tax laid generally on net incomes. And while it cannot be applied to any income which Congress has no power to tax (see *Stanton v. Baltic Mining Co.*, 240 U. S., 554), it is both nominally and actually a general tax. *It is not laid on income from exportation because of its source, or in a discriminative way, but as it is just laid on other income.* The words of the Act are 'Net Income arising or accruing from all sources.' There is no discrimination. At most exportation is affected only indirectly and remotely. The tax is levied after exportation is completed, *after all expenses are paid and losses adjusted and after the receipt of the income is free to use it as he chooses.*" (Italics ours).

It will be noted that the tax as laid was not a tax on income

from exportation because of its source, but upon the income *after all expenses were paid and losses adjusted*. the Income Tax Act of North Carolina, we respectfully submit, is laid in a discriminatory way, because no corporations except those engaged as common carriers of interstate or foreign commerce by railroad, pipe line or of intelligence are taxed in the same way, and is a tax laid upon operating revenue, because of its source, for that all expenses and losses are not allowed to be deducted but only certain classes of expense designated by the Act.

The distinguishing features of the taxes involved in *Crew Levick Company v. Pennsylvania*, *supra*, held void, and *William E. Peck Company v. Lowe*, *supra*, held valid, are clearly defined in *United States Glue Co. v. Oak Creek*, 247 U. S., 321 at page 328, where Mr. Justice Brandeis for the Court says:

“The distinction between direct and indirect burdens, with particular reference to a comparison between a tax upon the gross returns of carriers in interstate commerce and a general income tax imposed upon all inhabitants, incidentally affecting carriers engaged in such commerce, was the subject of consideration in *Philadelphia & S. Mail Co. v. Pennsylvania*, 122 U. S., 345, where the Court, by Mr. Justice Bradley said: ‘The corporate franchise, the property, the business, the income of corporations created by a state, may undoubtedly be taxed by the state; but in imposing such taxes care should be taken not to interfere with or hamper, directly or by indirection, interstate or foreign commerce, or any other matter exclusively within the jurisdiction of the Federal Government.’ Many previous cases were referred to.

“The correct line of distinction is so well illustrated in two cases decided at the present term that we hardly need go further. In *Crew Levick Co. Pennsylvania*, 245 U. S., 292, we held that a state tax upon the business of selling goods in foreign commerce, measured, by a certain percentage of the gross transactions in such commerce, was

by its necessary effect a tax upon the commerce, and at the same time a duty upon exports, contrary to paragraphs 8 and 10 of Article 1 of the Constitution, since it operated to lay a direct burden upon every transaction by withholding for the use of the state a part of every dollar received. On the other hand, in *Peck & Co. v. Lowe*, 247 U. S., 165, we held that the income tax of October 3, 1913, chap. 16, paragraph 2, Stat. at L. 166, 172, when carried into effect by imposing an assessment upon the entire net income of a corporation, approximately three-fourths of which was derived from the export of goods to foreign countries, did not amount to laying a tax or duty on articles exported within the meaning of Art. 1, Sec. 9, cl. 5 of the Constitution. The distinction between a direct and an indirect burden by way of tax or duty was developed, and it was shown that an income tax laid generally on net incomes, *not on income from exportation but just as it was laid on other income, and affecting only the net receipts from exportation after all expenses were paid and losses adjusted and the recipient of the income was free to use it as he chose, was only an indirect burden.*" (Italics ours).

The fact that the Income Tax Act of North Carolina does not purport to lay a tax upon gross earnings does not affect its invalidity, for as shown, this Court must consider *the effect of the tax*, and the effect of this Act is to tax gross earnings, in that it does not allow to railroad companies those necessary items of expense in the production of the income such as expense rent for the use of property, interest paid and other expenses.

V.

THE ENTIRE SCHEME OF TAXATION IS ILLEGAL
BECAUSE IN VIOLATION OF THE UNIFORMITY
CLAUSE OF THE CONSTITUTION OF NORTH CARO-
LINA.

This Court in *Galveston, H. & A. R. R. v. Texas*, 210 U. S. 217, says:

"When a Legislature is trying simply to value property, it is less likely to attempt or to effect injurious regulation than when it is aiming directly at the receipts from interstate commerce. *A practical line can be drawn by taking the whole scheme of taxation into account. This must be done by this Court as best it can. Neither the State Courts nor the Legislatures, by giving a tax a particular name, or by the use of some form of words, can take away our duty to consider its nature and effect.*"
(Italics ours).

As said by the Court in this case it is necessary, therefore, to take into consideration the entire scheme of taxation established by the Legislature of North Carolina in order to understand and determine whether or not the scheme of taxation employed is, as a whole, legal. This scheme is as follows:

(1) The property of railroads in North Carolina is valued and assessed at its actual value as a whole as a going concern, and upon this is levied an ad valorem tax which goes to the counties, cities, towns and other taxing districts.

(2) Upon this same valuation and assessment at actual value as a going concern there is then levied a tax of one-tenth of one per cent for State purposes.

Of course these two assessments take in the entire property of the plaintiff, real, personal and intangible, as a going concern and at full value, and necessarily include the mileage proportion in the State of interstate Commerce, because that proportion of intangible value is arrived at under the statute from earnings. Therefore, the property as a going concern,

including earnings derived from interstate commerce, is taxed by these two methods.

(3) There is then levied another tax superimposed upon these two taxes, and that is this so-called Income Tax, which, when applied to railroads keeping their accounts in accordance with the standard classification of accounting of the Interstate Commerce Commission, is nothing more nor less than a tax upon the gross receipts derived from interstate commerce from which is deducted:

- (a) Uncollectible revenue.
- (b) Taxes paid in the State other than income taxes and war profits and excise profits taxes, and
- (c) Car hire.

This scheme of taxation is in violation of the Constitution of North Carolina.

The Constitution of North Carolina provides, Section 3 of Article 5, and Section 9 of Article 7, that the State, county, town and township taxes shall be uniform and ad valorem upon all property in the same except property exempt by this Constitution. We say that it shall be ad valorem because Section 3 says:

"Laws shall be passed taxing by a uniform rule all moneys, credits, investments in bonds, stocks, joint stock companies, or otherwise; and also all real and personal property according to its true value in money."

The Legislature of North Carolina, in the Revenue Act of 1921, Section 3, violates this provision of the Constitution, because it levied no tax on any such property in the State for the uses of the State government. This section is as follows:

"Sec. 3. State taxes. No tax on any property in the State shall be levied for any of the uses of the State Government. The taxes hereinafter levied in this act are for the expenses of the State Government, the appropriations to its educational, charitable, and penal institutions, pen-

sions for Confederate soldiers and widows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer."

When the Legislature of North Carolina undertakes, in violation of the express terms of the Constitution, to set up a taxing system prohibited by the Constitution, it necessarily is illegal.

The plain mandate of the Constitution provides that uniform ad valorem taxes shall be levied on real and personal property for State, county, city and township taxes.

That the Legislature has not the discretionary power to levy or not levy these ad valorem taxes on all real and personal property has been consistently confirmed by the decisions of this Court. The rule is stated in *Commissioners v. Tobacco Co.*, 116 N. C., at page 446 by Chief Justice Clark, then Associate Justice, as follows:

"As to corporations, by all the authorities, it is in the power of the legislature to lay the following taxes, two or more of them in its discretion at the same time: 1. To tax the franchise (including in this the power to tax also the corporate dividends). 2. The capital stock. 3. The real and personal property of the corporation. *This tax is imperative and not discretionary under the ad valorem feature of the Constitution.* 4. The shares of stock in the hands of the stockholder. This is also imperative and not discretionary." (Italics added).

"The Constitution, Art. 5, Sec. 3, commands that: Laws shall be passed taxing by a uniform rule all moneys, credits, investments in bonds, stocks, joint stock companies, or otherwise; and also all real and personal property according to its true value in money. It is apparent from an examination of the taxing laws of the State that the legislative department has attempted to observe and enforce *the mandate of the Constitution.*" (Italics added).

To the same effect are found exp
following cases :

ssion, 152 N. C., page 553.

Pullen v. Corporation Comm^{140.}

Smith v. Wilkins, 164 N. C. C., at page 214.

Guano Co. v. Biddle, 158 N. C., at page 573.

C., 165.

Lacy v. Packing Co., 134 N. C., 177 N. C., 430.

Railroad v. New Bern, 147 N. C., 445.

Bickett v. Tax Commission, C., 10.

Kyle v. Commissioners, 75 N.

R. R. v. Commissioners, 72 , city, town or township
upon all property in the

"All taxes levied by any coun^{this constitution.}" Art.
shall be uniform and ad valorem
same, except property exempted Elmond v. Commissioners,
VII, Sec. 9. held that it was not in-

In construing this section in Rity to the subjects alone
106 N. C., 122, the Supreme Couion in granting a munici-
tended to apply the rules of uniforerty in the municipality
selected by the Legislature for taxaly and equal. In the
pal charter but requires that all p^{erd says:}
shall be taxed, and taxed unifor
opinion of the Court, Justice Shem the Legislature, and it

"In the absence of constitut^{against a particuar class}
is said, no restraint whatever ^{laws in violation of every}
may discriminate in favor of ^{an unequal distribution}
of persons or property, and pa^{upon such an abuse of}
principle of just government, ^{constituents over their}
of the public burdens. The cl^{of authority is that the}
power is in the influence of ^{with this exercise of the}
representatives; and the weighd is open for a war be-
courts have no right to interfecy, in that one class may
legislative will. ^{he prejudice of another.}

Thus it is seen that a widee government, an excited
tween different classes of prop
be taxed to the exclusion or t
and that under the forms of a

partisan legislative majority may commit wrongs against the rights of property as flagrant and oppressive as those which have disgraced the reigns of the most despotic rulers.

But it is said that the General Assembly will be influenced by proper motives, and will levy taxes upon a just basis. Experience, in many of the states, has shown that the principles of taxation should not be left to the uncertainty or caprice of successive legislatures, but that they should be fixed and immutable, and embodied in the fundamental law, under whose broad shield all property, of whatsoever species, may be protected.

This, we think, was the purpose of the framers of our Constitution in inserting therein the section referred to, as well as Section 3, Art. 5, relating to State taxation.

No one who reads these and other provisions of the Constitution will fail to be impressed with the earnest effort there made to engraft upon our organic law the great principle of equality in taxation."

The Legislature has seen fit to violate the express provisions of the Constitution of North Carolina and levied no tax whatever on moneys, credits, investments in bonds, stocks, joint stock companies, or real and personal property for State purposes. It has, in violation of this provision of the Constitution, delegated to the counties and cities the right to levy taxes for these purposes, and in order to make up the deficit for the State Treasury, created by this system of taxation, it proposes, for State purposes, to levy an income tax and tax upon corporations of every class and character.

We have already referred the Court to the Redmond case, and quoted fully from that case to show that these provisions of the Constitution are mandatory. This scheme of taxation is predicated upon the desire to take from the earnings of corporations, and especially of public service corporations in North Carolina, a greater amount in taxation in proportion to their property values than other citizens of the State. The

farmer is exempt from paying any tax upon his farm for the operating expenses of the State government. No scheme of taxation not authorized by the Constitution of the State can exist.

As said by Justice Shepherd in the Redmond case, after referring to various cases:

"These cases decide that, when the taxing power is exercised for a public purpose, *the Constitution, and not the Legislature, declares what property shall be taxed, and by a uniform rule, and ad valorem.*"

In that case there was a question of the taxation of personal property. He then further says:

"All taxes, therefore, must be levied as well on personal as on real property."

This being the interpretation of the Constitution of North Carolina by the Supreme Court of that State, it is binding upon this Court.

There was no power or authority in the Legislature to put into effect a scheme of taxation in violation of the mandate of the Constitution.

We respectfully submit, therefore, that the tax is invalid and that plaintiff is entitled to an interlocutory injunction, and the decree of the District Court should be reversed.

THOMAS W. DAVIS,

Solicitor for Appellant.

GEO. B. ELLIOTT,

HARRY SKINNER,

Of Counsel,

Wilmington, N. C., March 9th, 1923.

APPENDIX

Extracts from

Constitution of North Carolina:

Article V.

"Section 3. Taxation

Valorem: Exemption shall be by Uniform Rule and ad uniform rule all moneys.—Laws shall be passed taxing by a joint stock companies, credits, investments in bonds, stocks, personal property, access, or otherwise; and also all real and

* * * The General Assembly may also tax trades, professions, franchises and incomes," etc.

"Section 6. Taxes

State and county tax Levied for Counties.—The total of the cents on the one hundred dollars value of property shall not exceed fifteen when the county property tax is levied for a special purpose and with the special approval of the General Assembly, which may be done by special or general act: Provided, this limitation shall not apply to taxes levied for the maintenance of the public schools of the State for the term required by article nine, section three, of the Constitution: Provided, further, the state tax shall not exceed five cents on the one hundred dollars value of property."

Article VII.

"Section 9.—All taxes levied by any county, city, town or township shall be uniform and ad valorem upon all property in the same except property exempted by this Constitution."

Extracts from Consolidated Statutes of North Carolina:

Section 7979. Remedies of Taxpayer for unauthorized tax.—

Unless a tax or assessment of Taxpayer for unauthorized tax.—or invalid, or be levied for an illegal or unauthorized purpose, no injunction, or some part thereof, be illegal or judge to restrain the collection thereof in whole or in part, nor to restrain the sale of any property for the nonpayment of any property for the nonpayment

thereof; nor shall any court issue any order in claim and delivery proceedings or otherwise for the taking of any personalty levied on by the sheriff to enforce payment of such tax or assessment against the owner thereof. Whenever any person shall claim to have a valid defense to the enforcement of a tax or assessment charged or assessed upon his property or poll, such person shall pay such tax or assessment to the sheriff; but, if, at the time of such payment, he shall notify the sheriff in writing that he pays the same under protest, such payment shall be without prejudice to any defenses or rights he may have in the premises, and he may, at any time within thirty days after such payment, demand the same in writing from the Treasurer of the State or of the county, city, or town, for the benefit or under the authority or by request of which the same was levied; and if the same shall not be refunded within ninety days thereafter, may sue such county, city, or town for the amount so demanded, including in his action against the county both State and county tax; and if, upon the trial it shall be determined that such tax or any part thereof was levied or assessed for an illegal or unauthorized purpose, or was for any reason invalid or excessive, judgment shall be rendered therefor, with interest, and the same shall be collected as in other cases. The amount of State taxes for which judgment shall be rendered in such action shall be refunded by the State Treasurer.

EXTRACTS FROM REVENUE ACT OF NORTH CAROLINA

Ch. 34, Public Laws, 1921

Sec. 3. State taxes.

No tax on any property in the State shall be levied for any of the uses of the State Government. The taxes hereinafter levied in this act are for the expenses of the State Government, the appropriations to its educational, charitable, and penal institutions, pensions for Confederate soldiers and wid-

ows, the interest on the debt of the State, an equalizing fund for public schools, and other specific appropriations made by law, and shall be collected and paid into the general fund of the State Treasurer.

Sec. 64. Tangible and intangible property assessed separately.

(a) At such dates as real estate is required to be assessed for taxation, the said commission shall first determine the value of the tangible property of each division or branch of such railroad of rolling stock and all other physical or tangible property. This value shall be determined by a due consideration of the actual cost of replacing the property, with a just allowance for depreciation on rolling stock, and also of other conditions, to be considered as in the case of private property.

(b) They shall then assess the value of the franchise, which shall be determined by due consideration of the gross earnings as compared with the operating expenses, and particularly by consideration of the value placed upon the whole property by the public (the value of the physical property being deducted), as evidenced by the market value of all capital stock, certificates of indebtedness, bonds, or any other securities, the value of which is based upon the earning capacity of the property.

(c) The aggregate value of the physical or tangible property and the franchise as thus determined, shall be the true value of the property for the purpose of an ad valorem taxation, and shall be apportioned in the same proportion that the length of such road in each county bears to the entire length of such division or branch thereof; and the State Tax Commission shall certify, on or before the first day of September, to the chairman of the county commissioners and the mayor of each city or incorporated town the amount apportioned to his county, city or town: all taxes due the State from any railroad company shall be paid by the treasurer of each company directly to the State Treasurer within thirty days after the first day of July of each year; and upon failure to pay the

State Treasurer as aforesaid, he shall institute an action to enforce the same in the county of Wake or any other county in which such railroad is located, adding thereto twenty-five per centum of the tax. The board of county commissioners of each county through which said railroad passes shall assess against the same only the tax imposed for each county, township, or other taxing district purposes, the same as is levied on other property in such county, township, or special taxing districts.

Sec. 6. Railroads.

When any railroad has part of its road in this State and part thereof in any other State, the said commission shall ascertain the value of railroad track, rolling stock, and all other property liable to assessment by the State Tax Commissioner of such company as provided in the next proceeding section, and divided in the proportion to the length such main line or road in this State bears to the whole length of such main line of road, and determine the value in this State accordingly: Provided, the commission shall, in valuing the fixed property in this State, give due consideration to the character of the roadbed and fixed equipment, number of miles of double track, the amount of gross and net earnings per mile of road in this State, and any other factor which would give a greater or less value per mile of road in this State than the average value for the entire system. On or after the first Monday in July the said commission shall give a hearing to all the companies interested, touching the valuation and assessment of property. The said commission may, if they see fit, require all argument and communications to be presented in writing.

Sec. 82 (61½). Railroads.

Every railroad company doing business in this State shall annually on or before the thirtieth day of July make and return to the State Tax Commission, in such form and upon such blanks as shall be furnished by the State Tax Com-

mission, and giving such information as the State Tax Commission shall require, for the purpose of carrying out the provisions of this section, and upon which report the State Tax Commission shall ascertain and certify to the State Auditor the value upon which the amount of taxes which shall be paid by any such railroad company as a franchise or privilege tax shall be calculated. The basis upon which such calculation shall be made by the State Tax Commissioner and the extent to which every such railroad company is exercising its franchise in this State shall be found to be the value of the property, tangible and intangible, of each such railroad company in the State assessed for the year in which such report is made for ad valorem taxes. The franchise tax of each such railroad franchise in this State shall be one-tenth of the one per cent (0.1%) of the value so ascertained by the State Tax Commission, and such tax shall be due and payable on or before the fifteenth day of October in each year. If any such company shall fail to make the report provided for, it shall be the duty of the State Tax Commission to make an approximation from the reports and records on file in that department of the amount of taxes due under this section, and certify same to the State Auditor and Treasurer for collection. No county, city or town shall be allowed to collect any taxes under this section.

"Sec. 101. Purpose. The general purpose of this act is to impose a tax, for the use of the State Government, upon the net income for the calendar year 1921, in excess of the exemptions herein set out, collectible in the year 1922, and annually thereafter: (a) Of every citizen of the State. (b) Of every domestic corporation. (c) Of every foreign corporation and of every non-resident individual having a business or agency in this State, in proportion to the net income of such business or agency.

Except as otherwise provided in this act the purpose is to conform to the definitions of income in the revenue laws of the United States Government and regulations made under its authority, in so far as they apply.

The tax imposed upon the net income of corporations in this schedule is in the nature of a franchise tax for the privilege granted by the State to domestic corporations and to foreign corporations doing business in this State, and is in addition to the tax imposed under Schedule C of this act."

"Sec. 102. Definitions. For the purpose of this act and unless otherwise required by the context:

1. The words "Tax Commission" mean the State Tax Commission.

2. The word "taxpayer" includes the individual, corporation or fiduciary subject to the tax imposed by this act.

3. The word "individual" means a natural person.

4. The word "fiduciary" means a guardian, trustee, executor, administrator, receiver, conservator, or any person, whether individual or corporation, acting in any fiduciary capacity for any person, estate or trust.

5. The word "person" includes individuals, fiduciaries, partnerships and corporations.

6. The word "corporation" includes joint-stock companies or associations and insurance companies.

7. The words "domestic corporation" mean any corporation organized under the laws of this State.

8. The words "foreign corporation" mean any corporation other than a domestic corporation.

9. The words "tax year" mean the calendar year in which the tax is payable.

10. The words "income year" mean the calendar year or the fiscal year, upon the basis of which the net income is computed under this act: if no fiscal year has been established they mean the calendar year.

11. The words "fiscal year" mean an income year, ending on the last day of the month other than December.

12. The word "paid" for the purposes of the deductions under this act means "paid or accrued" or "paid or incurred," and the words "paid or accrued," "paid or incurred," and "incurred," shall be construed according to

the method of accounting upon the basis of which the net income is computed under this act. The word "received" for the purpose of the computation of the net income under this act means "received or accrued," and the words "received or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this act.

13. The word "resident" applies only to individuals, and includes for the purpose of determining liability to the tax imposed by this act, with reference to the income of any income year, any individual who shall be a resident of the State on the first day of the tax year. In the absence of other satisfactory indicia the residence of a person who has two or more places in which he occasionally dwells may be determined with reference to the place at which the individual lived the longest period of time during the income year.

14. The words "foreign country" mean any jurisdiction other than one embraced within the United States. The words "United States," when used in a geographical sense, include the States, the Territories of Alaska and Hawaii, the District of Columbia, and the possessions of the United States."

"Sec. 201. Corporations. Every corporation organized under the laws of this State shall pay annually a franchise or excise tax, with respect to carrying on or doing business, equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the income year; and every foreign corporation doing business in this State shall pay annually a franchise or excise tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules:

This section was amended on December 19th, 1921, at the special session of the Legislature of North Carolina of 1921, being Chapter 102 of the Public Laws of North Carolina, Special Session 1921, as follows:

"Section 201. Corporations. Every corporation organized under the laws of this State shall pay annually an income tax equivalent to three per cent of the entire net income of such corporation, as herein defined, received by such corporation during the year; and every foreign corporation doing business in this State shall pay annually an income tax equivalent to three per cent of a proportion of its entire net income, to be determined according to the following rules."

In case of a company other than companies mentioned in the next succeeding section, deriving profits principally from the ownership, sale or rental of real estate or from the manufacture, sale, or use of tangible personal property such proportion of its entire net income as the fair cash value of its real estate and tangible personal property in this State on the date of the close of the fiscal year of such company in the income year is to the fair cash value of its entire real estate and tangible personal property then owned by it, with no deduction on account of incumbrances thereon.

In case of a corporation deriving profits principally from the holding or sale of intangible property, such proportion as its gross receipts in this State for the year ending on the date of the close of its fiscal year next preceding is to its gross receipts for such year without the State."

Sec. 202. Railroads and Public Service Corporations. The basis of ascertaining the net income of every corporation engaged in the business of operating a steam or electric railroad express service, telephone or telegraph business, or other form of public service, when such company is required to keep records according to the standard classification of the accounting of the Interstate Commerce Commission, shall be the 'net operating income' of such corporations as shown by their records kept in accordance with that standard classification of accounts, when their business is wholly within this State, and when their business is in part

within and part without the State their net income within this State shall be ascertained by taking their gross 'operating revenues' within this State, including in their gross 'operating revenues' within this State the equal mileage proportioned within this State of their interstate business and deducting from their gross 'operating expenses,' or 'operating ratio,' for their whole business, as shown by the Interstate Commerce Commission standard classification of accounts. From the net operating income thus ascertained shall be deducted 'uncollectible revenue,' and taxes paid in this State for the income year, other than income taxes and war profits and excess profits taxes, and the balance shall be deemed to be their net income taxable under this act."

"Sec. 203. Such tax shall first be levied, collected, and paid in the year 1922, and with respect to the net income received during the calendar year 1921 or during any income year ending during the twelve months ending March 31, 1922."

"Sec 300. Net income defined. The words 'net income' mean the gross income of a taxpayer less the deductions allowed by this act."

"Sec. 301. Gross income defined. 1. The words 'gross income' include gains, profits and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gains or profits, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income of the income year in which received by the taxpayer, unless, under the methods of accounting permitted under this act, any such amounts are to be properly accounted for as of a different period.

2. The words 'gross income' do not include the following items, which shall be exempt from taxation under this act.

(a) The proceeds of life insurance policies and contracts paid upon the death of the insured to individual beneficiaries or to the estate of the insured.

(b) The amount received by the insured as a return of premium or premiums paid by him under life insurance, endowment or annuity contracts, either during the term or at the maturity of the term mentioned in the contract or upon surrender of the contract.

(c) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income).

(d) Interest upon the obligations of the United States or its possessions, or of the State of North Carolina.

(e) Salaries, wages, or other compensation received from the United States by officials or employees thereof, including persons in the military or naval forces of the United states.

(f) Any amounts received through accident or health insurance or under workman's compensation acts, as compensation for the personal injuries or sickness, plus the amount of any damages received, whether by suit or agreement, on account of such injuries or sickness."

"Sec. 306. Deductions. In computing net income there shall be allowed as deductions:

1. All the ordinary and necessary expenses paid during the income year in carrying on any trade or business including:

(a) As to individuals, wages of employees for service actually rendered in producing such income.

(b) As to partnerships, wages of employees and a reasonable allowance for copartners or members of a firm, for services actually rendered in producing such income, the amount of such salary allowance to be included in the personal return of the copartner receiving same.

(c) As to corporations, wages of employees and salaries of officers, if reasonable in amount, for services actually rendered in producing such income.

2. Rentals or other payments required to be made as a condition of the continued use or possession, for the purposes of the trade of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

3. All interest paid during the income year on indebtedness except interest on obligations contracted for the purchase of non-taxable securities. Dividends on preferred stock shall not be deducted as interest.

4. Taxes for the income year, except taxes on income and war profits, and excess profits taxes, inheritance taxes, and taxes assessed for local benefit of a kind tending to increase the value of the property assessed.

5. Dividends from stock in any corporation the income of which shall have been assessed and the tax on such income paid by the corporation under the provisions of this act: Provided, that when only a part of the income of any corporation shall have been assessed under this act only a corresponding part of the dividends received therefrom shall be deducted.

6. Losses sustained during the income year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit.

7. Debts ascertained to be worthless and charged off within the income year, if the amount has previously been included in gross income in a return under this act.

8. A reasonable allowance for the depreciation and obsolescence of property used in the trade or business; and, in the case of mines, oil, and gas wells, other natural deposits, and timber, a reasonable allowance for depletion: Provided, that in computing the deductions allowed under this paragraph, the basis shall be the cost (including in the case of mines, oil and gas wells, and other natural deposits, the cost of development, not otherwise deducted), and in the

case of property acquired prior to January 1, 1921, the fair market value of the property (or the taxpayer's interest therein) on that date and shall be taken in lieu of cost up to that date. The reasonable allowances under this paragraph shall be made under rules and regulations to be prescribed by the Tax Commission. In the cases of leases the deductions allowed may be equitably apportioned between the lessor and lessee.

9. In the case of taxpayers who keep regular books of account, upon an accrual basis and in accordance with standard accounting practice, reserves for bad debts and for contingent liabilities, under such rules and restrictions as the Tax Commission may impose. If the Tax Commission shall at any time deem the reserve excessive in amount it may restore such excess to income, either in a subsequent year or as a part of the income of the income year and assess it accordingly.

10. Contributions or gifts made within the taxable year to corporations or associations operating exclusively for religious, charitable, scientific or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, to an amount not in excess of fifteen per centum of the taxpayer's net income as computed without the benefit of this subdivision.

11. Resident individuals having an established business in another State, or investment in property in another State, may deduct the net income from such business or investment, if such business or investment is in a State that levies a tax upon such income. The deduction authorized in this subsection shall in no case extend to any part of income of resident individuals from personal services, or mortgages, stocks, bonds, securities and deposits.

12. In the case of a nonresident individual, the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising

from sources within the State; and the proper apportionment and allocation of the deductions with respect to sources of income within and without the State shall be determined under rules and regulations prescribed by the State Tax Commission."

ARTICLE VI

Penalties

Sec. 600. Penalties. 1. If any taxpayer, without intent to evade any tax imposed by this act shall fail to file a return of income or pay a tax, if one is due, at the time required by or under the provisions of this act, but shall voluntarily file a correct return of income and pay the tax due within sixty days thereafter, there shall be added to the tax an additional amount equal to five percent thereof, but such additional amount shall in no case be less than one dollar and an additional one per cent for each month or fraction of a month during which the tax remains unpaid.

2. If any taxpayer fails voluntarily to file a return of income or pay a tax, if one is due, within sixty days of the time required by or under the provisions of this act, the tax shall be doubled, and such double tax shall be increased by one per cent for each month or fraction of a month from the time the tax was originally due to the date of payment.

3. The Tax Commission shall have power, upon making a record of its reasons therefor, to waive or reduce any of the additional taxes or interest provided in subdivisions 1 and 2 of this section, or in subdivisions 2, 3, and 4 of section 501.

4. If any taxpayer fails to file a return within sixty days of the time prescribed by this act, any judge of the Superior Court, upon petition of the Tax Commission, or of any ten taxable residents of the State, shall issue a writ of mandamus requiring such person to file a return. The order of notice upon the petition shall be returnable not later than ten days after the filing of the petition. The petition shall be heard and determined on the return day or on such day

thereafter as the Court shall fix, having regard to the speediest possible determination of the case, consistent with the rights of the parties. The judgment shall include costs in favor of the prevailing party. All writs and processes may be issued from the clerk's office in any county and, except as aforesaid, shall be returnable as the Court shall order.

5. Any person who, without fraudulent intent, fails to pay any tax or to make, render, sign or verify any return, or to supply any information, within the time required by or under the provisions of this act, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the Attorney General, in the name of the people, by action in any court of competent jurisdiction.

6. Any person or officer or employee of any corporation, or member or employee of any partnership, who, with intent to evade any requirement of this act, or any lawful requirement of the Tax Commission thereunder, shall fail to pay any tax or to make, sign, or verify any return, or to supply any information required by or under the provisions of this act, or who, with intent, shall make, render, sign, or verify any false or fraudulent return or statement, or shall supply any false or fraudulent information, shall be liable to a penalty of not more than one thousand dollars, to be recovered by the Attorney General in the name of the people, by action in any court of competent jurisdiction, and shall also be guilty of a misdemeanor, and shall, upon conviction, be fined not to exceed one thousand dollars or be imprisoned not to exceed one year, or both, at the discretion of the Court.

7. The Attorney General shall have the power, with the consent of the Tax Commission, to compromise any penalty for which he is authorized to bring action under subdivisions 5 and 6 of this section. The penalties provided by such subdivision shall be addition to all other penalties in this act provided.

8. The failure to obey any act required by or under the provisions of this act shall be deemed an act committed in

part at the office of the Tax Commissioner in Raleigh. The certificate of the Tax Commission to the effect that a tax has not been paid, that a return has not been filed, or that information has not been supplied, as required by or under the provisions of this act, shall be prima facie evidence that such tax has not been paid, that such return has not been filed, or that such information has not been supplied.

9. If any taxpayer who has failed to file a return, or has filed an incorrect or insufficient return, and has been notified by the Tax Commission of his delinquency, refuses or neglects within twenty days after such notice to file a proper return, or files a fraudulent return, the Tax Commission shall determine the income of such taxpayer, according to its best information and belief, and assess the same at not more than double the amount so determined. The Tax Commission may, in its discretion, allow further time for the filing of a return in such case.

ARTICLE VII

Revision and Repeal

Sec. 700. Revision by Tax Commission. A taxpayer may apply to the Tax Commission for revision of the taxes assessed against him, at any time within one year from the time of the filing of the return or from the date of the notice of the assessment of any additional tax. The Tax Commission shall grant a hearing thereon, and if, upon such hearing, it shall determine that the tax is excessive or incorrect, it shall resettle the same according to the law and the facts and adjust the computation of tax accordingly. The Tax Commission shall notify the taxpayer of its determination and shall refund to the taxpayer the amount, if any paid in excess of the tax found by it to be due. If the taxpayer has failed, without good cause, to file a return within the time prescribed by law, or has filed a fraudulent return, or, having filed an incorrect return, has failed, after notice, to file a proper return, the Tax Commission shall not reduce the tax below double the

amount for which the taxpayer is found to be properly assessed.

Sec. 701. Appeal. Any taxpayer may file formal exceptions to finding by the State Tax Commission with respect to his taxable income, and upon such exceptions being overruled, any such taxpayer shall have the right, upon the payment of the amount of tax found by the State Tax Commission to be due, and upon filing bond for cost in the sum of two hundred dollars, to have the record in such case certified to the Superior Court of the county in which the taxpayer resides, or has his principal place of business, within thirty days after notice by the Tax Commission of its determination, given as provided in section 700 of this act. Thereupon, appropriate proceedings shall be had and the relief, if any, to which the taxpayer may be found entitled may be granted and any taxes, interest or penalties paid, found by the Court to be in excess of those legally assessed, shall be ordered refunded to the taxpayer, with interest from time of payment

Chapter 96. Public Laws of North Carolina, Extra Session 1921.

"Section 1. Whenever taxes of any kind are or have been through clerical error, or misinterpretation of the law, or otherwise, collected and paid into the State Treasury in excess of the amount legally due the state, the State Auditor shall issue a warrant for the amount so illegally collected, to the person entitled thereto, upon certificate of the head of the department through which said taxes were collected or his successor in the performance of the functions of that department, with the approval of the Attorney General, and the Treasurer shall pay the same out of the funds in the treasury not otherwise appropriated: Provided, demand is made for the correction of such error or errors within two years from the time of such payment: Provided further, that claims which have arisen within the five years next preceding the ratification of this act shall be presented

and made within two years from the ratification of this act,

"Sec. 2. This act shall be in force and effect from and after its ratification.

"Ratified this 19th day of December, A. D., 1921."

CHAP. 40, PUBLIC LAWS 1921.

AN ACT TO TRANSFER THE POWERS AND DUTIES OF THE STATE TAX COMMISSION TO THE STATE DEPARTMENT OF REVENUE.

The General Assembly of North Carolina do enact :

Section 1. From and after the first day of May, one thousand nine hundred and twenty-one, all the powers and duties imposed by any act of law, including Revenue and Machinery Acts, enacted by the present session of the General Assembly, upon the State Tax Commission, shall be transferred to and imposed upon the department to be known as the State Department of Revenue, created by this act, to be administered by the Commissioner of Revenue, to be appointed as provided in this act. All such powers and duties, except as otherwise provided herein, shall devolve upon the Commissioner of Revenue, and wherever in the revenue laws of the State the words "State Tax Commission" are used such words shall, after May first, one thousand nine hundred and twenty-one, be held to mean Commissioner of Revenue, except as otherwise provided in this act.

Sec. 2. There is hereby created the office of Commissioner of Revenue, to be appointed by the Governor, by and with the advice and consent of the Senate, and if such appointment is made when the Senate is not in session, confirmation may be by the Senate at the next session. The term of office shall be for four years from and after the first day of May, one thousand nine hundred and twenty-one, and the succeeding commissioner of revenue shall be nominated and elected in the year one thousand nine hundred and twenty-four, in the

manner provided for the nomination and election of other State officers, and quadrennially thereafter.

Sec. 3. The powers and duties now exercised by the State Tax Commission as a State Board of Equalization, and the appellate authority exercised by the said Tax Commission in determining appeals from the valuation made by assessing officers in the several counties of the State, shall, from and after the first day of May, one thousand nine hundred and twenty-one, be held and exercised by a State Board of Equalization, composed of the Commissioner of Revenue, the chairman of the Corporation Commission, and the Attorney-General, who shall be ex officio members of and constitute the State Board of Equalization, to have and exercise the powers and duties now imposed by law upon the State Tax Commission as a State Board of Equalization, and as an appellate court, to hear and determine appeals from valuation of property by assessing officers in the several counties. The said board shall meet upon call of the Commissioner of Revenue as often as may be necessary to discharge the duties imposed by law upon the said board.